

Approved MONDAY 2-17-92
Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION

The meeting was called to order by Senator Dan Thiessen at
Chairperson

11:00 a.m. ~~p.m.~~ on Thursday, February 13, 1992 in room 519-S of the Capitol.

All members were present except:

Committee staff present:

Bill Edds, Revisors Office
Don Hayward, Revisors Office
Chris Courtwright, Research Department
Tom Severn, Research Department
Marion Anzek, Committee Secretary

Conferees appearing before the committee:

Senator Alicia Salisbury, Sponsor of **SB566**
Christie Young, Vice President-Governmental Relations, Greater Topeka Chamber of Commerce
David Cunningham, Director of Property Valuation Department, Dept. of Revenue

Chairman Dan Thiessen called the meeting to order at 11:05 a.m. and said the agenda today is a hearing on **SB566** and he recognized Senator Alicia Salisbury, sponsor of **SB566**.

SB566: Valuation of commercial real property for taxation purposes.

Senator Alicia Salisbury said **SB566** addresses the methodology to be used by County Apprasers in valuing property. She said the objective of this legislation is to achieve uniformity in appraisals in all the 105 counties in Kansas.

She said her interest in **SB566** is to statutorily create a methodology to uniformly and equally value commercial property grew out of her anticipation in a Shawnee County Task Force, which was appointed by the Shawnee County Commission to assess the methodology that was being used by the local appraiser to appraise property, and to publish their report and submit it to the County Commission.

She said, she wanted to point out some findings in the commercial property area, and she said, 1st would be to assess the methodology that was being used by the local appraisers to appraise property, and to publish and submit a report to the County Commission. She said, some of the findings in the commercial property area. She said 1st, it should be recognized in establishing specific measurements in the commercial property field that is handicapped, especially in Shawnee County and she said, she felt in many counties throughout Kansas, have inadequate sales comparables.

She said, in a Shawnee County appraiser's opinion, a coordinator that was responsible for the initial reappraisal, manipulated neighborhoods to overcome deficiencies in the computer system, in order to achieve a better resolve in the valuation. She said, this has now been recognized by the County Appraiser, who is attempting to make those adjustments and in making the adjustments, it made another ripple throughout the commercial community.

She said, it is clear from the material that has been received from the PVD and the Director, that various county appraisers are not following, and in some cases not utilizing the income approach in the appraising of commercial property.

She said from reports received by the Director of Property Valuation, it is clear that the KS CAMA system is flawed and is producing non uniform and unequal values. She said, the Attorney General has expressed his opinion, and as a law it is unconstitutional as she understands it and it concurred with the PVD.

After committee discussion Chairman Thiessen recognized Christy Young, Vice President Government Relations, Greater Topeka Chamber of Commerce.

Christie Young, said they believe **SB566** sends a clear message that a serious problem exists in the appraisal of commercial property in our state. She said, those of us in Shawnee County know first hand the mess that can be created when a county appraisal office uses mass appraisal methods, based upon inadequate or inaccurate data to appraise commercial property that should have been individually appraised from the beginning.

She said in review of the bill, they offer some substitutions and additions to the language.

She said, attached to her hand-out (ATTACHMENT 1) they offer their support for

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION,

room 519-S, Statehouse, at 11:00 a.m. ~~p.m.~~ on Thursday, February 13, 1992.

immediate action to create an appraisal system that is accurate, fair, and up-front, so the perception and the reality of tax fairness is based upon good appraisals that honestly reflect the market value of property across the state.

Senator Fred Kerr asked Christy Young if the task force or PVD has figures on how much the commercial valuation has dropped, and if not could she get this information for the committee? Christy Young said she did not know, but would try to get this information.

Larry Clark, President KS County Appraisers Association, appearing in **opposition of SB566** said **SB566** requires county appraisers to utilize an income approach estimate of value that is not based on the market and without any regard given to the quality of that estimate or other estimates made through the cost of comparative sales approaches. He said, it is their opinion this would be a direct violation of the constitutional requirements for a uniform and equal system of assessment and taxation, as it would not satisfy the definition of fair market value in 79-503a and would cause county appraisers in this state to violate Standard 6 of the Uniform Standards of Professional Appraisal Practice. Attached to his hand-out are copies of Standard Rule 6-4 states in appropriate part. He said, every major appraisal organization has adopted this standard, including the Appraisal Institute and the International Association of Assessing Officers. See (**ATTACHMENT 2**)

David Cunningham, Property Valuation Department said a lot of the various comments summarize his main concerns, he said this is based on the bill itself and he said they could simplify it to almost what the taxpayer is going to demand on the value of their commercial property. He said if uniformity is wanted **SB566** doesn't achieve uniformity because everybody's expenses and incomes are going to vary, so they will not be related to a particular market for commercial property. He said, he has no problem with the concept of saying the County Appraiser should be working in an income approach to value, that is one of the requirements that they should do now. He said, the SCR that Senator Salisbury mentioned, people walk into the appraisers office now and hold it up and say you are required by law to just use the income approach to value. He said if it becomes law, even if spelled out to say "as one of the 3 approaches you should use this." He said people would come in and say you can't use anything but this and here are my actual numbers and only use these numbers.

Chairman Thiessen said we are running out of time and we will have continued hearings on **SB566** at a later date.

Senator Phil Martin moved to adopt the minutes of February 11, 1992, 2nd by Senator Lana Oleen. The motion carried.

Chairman Dan Thiessen adjourned the meeting at 12:02 p.m.

GUEST LIST

COMMITTEE: ASSESSMENT & TAXATION

DATE: 2-13-92

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
DAVID CARPENTER	TOPEKA	
Gary Schnellbacher	Topeka	Schnellbacher & Co
HAROLD PITT	Topeka	AARP-CCTF
MERLE BLAIR	TOPEKA	GREATER TOPEKA CHAMBER OF COMMERCE
MARK RUSSELL	TOPEKA	LA SIESTA FOODS, INC.
Christy Young	Topeka	Gr. Topeka Chamber
Gludis Fische	Topeka	KFFT
Larry Fischer	Topeka	Citizen
NACK Benger	Topeka	KFFT
Russell A. FREY	Topeka	Ks Vet Med Assoc.
Brian J. Russell	FT. SCOTT	KSNA
Susie Rolling	Topeka	Washburn Student
Kimberly Ward	Topeka	Washburn University
Kathy Briggs	Topeka	Washburn Student Nurse
Bob Taggart	Topeka	Taggart & Assoc
Freddy Cron	"	Amer. Inst of Architects
Janak Stubbs	"	NBA of Ks
Chuck Hows	"	ICBA
Jack Crocker	"	Marshall Bldg -
Steve Jones	Wichita	Boeing
J. L. Frelund	Wichita	Boeing
Mary E. Turkington	Topeka	Ks. Motor Carriers Assoc
Jim K. B. ...	Topeka	Observer
Alan Steppat	Topeka	Pete McGill & Associates
Heidi DeVore	Topeka	Vic Miller

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TESTIMONY BEFORE THE SENATE ASSESSMENT AND TAXATION COMMITTEE
February 13, 1992
Christy Young, Vice President Government Relations
Greater Topeka Chamber of Commerce

The Greater Topeka Chamber of Commerce appreciates this opportunity to discuss with you the issue of reappraisal of commercial property. We believe SB 566 sends a clear message that a serious problem exists in the appraisal of commercial property in our state. Those of us in Shawnee County know first hand the mess that can be created when a county appraisal office uses mass appraisal methods, based upon inadequate or inaccurate data to appraise commercial property that should have been individually appraised from the beginning.

Last summer, the Topeka Chamber of Commerce requested that an independent review task force be developed to look into the problems the taxpayer of Shawnee County were having with the Appraisers Office. The final report was delivered to the Shawnee County Commission with the hope that some corrective action could be made to more accurately appraise property in Shawnee County. Our information indicates little substantive action has been taken to date.

Senator Salisbury was a member of that task force and with SB 566 attempts to define in law how commercial property should be appraised. Since our county appraiser repeatedly says to us: "If you don't like it, go to the Capitol and get the law changed," this is one attempt to do just that.

In review of this bill, we offer some substitutions and additions to the language. We firmly believe that all studies used by the county appraiser (income, vacancy rates, operating expenses and capitalization rates) should be documented with fact, and reviewed by either the Property Valuation Department or a review board of knowledgeable persons, established by individual county commissions.

We offer the attached revisions and our support for immediate action to create an appraisal system that is accurate, fair, and up-front, so the perception and the reality of tax fairness is based upon good appraisals that honestly reflect the market value of property across the state.

SENATE ASSESSMENT & TAX

ATT. 1
2-13-92

SENATE BILL No. 566

By Senator Salisbury

2-3

8 AN ACT relating to property taxation; concerning the valuation of
9 certain commercial property; amending K.S.A. 1991 Supp. 79-
10 1476 and repealing the existing section.
11

12 *Be it enacted by the Legislature of the State of Kansas:*

13 Section 1. K.S.A. 1991 Supp. 79-1476 is hereby amended to read
14 as follows: 79-1476. The director of property valuation is hereby
15 directed and empowered to administer and supervise a statewide
16 program of reappraisal of all real property located within the state.
17 Except as otherwise authorized by K.S.A. 19-428, and amendments
18 thereto, each county shall comprise a separate appraisal district under
19 such program, and the county appraiser shall have the duty of reap-
20 praising all of the real property in the county pursuant to guidelines
21 and timetables prescribed by the director of property valuation and
22 of updating the same on an annual basis. In the case of multi-county
23 appraisal districts, the district appraiser shall have the duty of reap-
24 praising all of the real property in each of the counties comprising
25 the district pursuant to such guidelines and timetables and of up-
26 dating the same on an annual basis. Commencing in 1990, every
27 parcel of real property shall be actually viewed and inspected by
28 the county or district appraiser once every four years. The director
29 shall require the initiation of such program of statewide reappraisal
30 immediately after the effective date of this act.

31 Compilation of data for the initial preparation or updating of in-
32 ventories for each parcel of real property and entry thereof into the
33 state computer system as provided for in K.S.A. 79-1477, and amend-
34 ments thereto, shall be completed not later than January 1, 1989.
35 Whenever the director determines that reappraisal of all real prop-
36 erty within a county is complete, notification thereof shall be given
37 to the governor and to the state board of tax appeals.

38 Valuations shall be established for each parcel of real property at
39 its fair market value in money in accordance with the provisions of
40 K.S.A. 79-503a, and amendments thereto.

41 *For all taxable years commencing after December 31, 1991, val-*
42 *uations of improved commercial real property shall be established* → consider
43 *according to its income earning capacity utilizing the following meth-*

ods. The appraiser shall request the property owner to submit in-
 formation on income, expense and vacancy information as well as
 capitalization rates pertaining to the property being appraised. The
 appraiser shall utilize the actual rent figures received by the property
 owner, unless the property is an owner-occupied property, rather
 than investment grade property; then in that event, the appraiser
 shall utilize market rents which have been established by studies and
 analysis of highly comparable and competitive properties in the rel-
 evant market area. The county appraiser shall have properly delin-
 eated neighborhoods and have complete local studies documented by
 neighborhood, relating to market rents, vacancy rates, operating

expenses, reserves for replacement, capitalization rate analysis, in-
 come information analysis, and like-type information and this in-
 formation shall be made available to the property owner for
 inspection and utilization during the appraisal process. The appraiser
 shall utilize in the income approach, the actual vacancy reported by
 the property owner unless the property owner has not submitted a
 vacancy factor. The appraiser shall include miscellaneous income
 generated by operation of the real property, but not derived from
 the rental of space. This shall not include the tenant's business
 income, including excess rents paid by owner-occupied properties
 for special use type structures. The county appraiser shall then cal-
 culate the gross annual rental income less the percentage allowance
 for vacancy and collection loss, and to that shall be added the
 miscellaneous income generated by operation of the real property
 which total sum will equal the effective gross income of the property.
 From the effective gross income, as calculated above, the county
 appraiser shall deduct the actual operational expenses furnished by
 the property owner, unless the property owner has failed to submit
 operational expenses. The county appraiser shall allow as an actual
 operating expense of the property, all ad valorem taxes assessed to
 the property in the preceding year. The county appraiser shall also
 deduct from the effective gross income, a category of reserves for
 replacement items, even if an owner has not done so, which shall
 be includable as an allowable deductible expense from the effective
 gross income and the county appraiser shall allow for the distinction
 between long-term life replacement items and short-term life re-
 placement items. The net income attributed to the property shall
 equal the effective gross income less the expenses allowed herein set
 forth and less the reserves for replacement items. The county ap-
 praiser shall utilize the capitalization rate supplied by the property
 owner, as that capitalization rate applies to the particular piece of
 property. The county appraiser may develop and document a cap-

consider
 along with
 allowance

either include

or utilize an
 effective tax
 rate.

allowance

consider

shall

→ (not including business income
 or excess rents created by
 the business)

→ or as documented by the
 County Appraiser,

→ an allowance for

→ and compared to the
 capitalization rate developed
 by the County Appraiser
 through proper studies and
 analysis on an annual basis.

1 *italization rate by using one of the various acceptable techniques*
2 *derived from highly comparable sales and highly comparable prop-*
3 *erties to compare to the capitalization rate prepared by the property*
4 *owner. In all instances, the capitalization rate utilized by the ap-*
5 *praiser shall have documented all of the relevant components of the*
6 *capitalization rate, including the discount rate, recapture rate and*
7 *risk factors. The estimate of value for the property shall be deter-*
8 *mined by dividing the capitalization rate into the net income as*
9 *herein derived.*

10 All studies supporting income, vacancy, operating expenses and
11 capitalization rates shall be established for each parcel
12 of land devoted to agricultural use upon the basis of the agricultural
13 income or productivity attributable to the inherent capabilities of
14 such land in its current usage under a degree of management re-
15 flecting median production levels in the manner hereinafter pro-
16 vided. A classification system for all land devoted to agricultural use
17 shall be adopted by the director of property valuation using criteria
18 established by the United States department of agriculture soil con-
19 servation service. For all taxable years commencing after December
20 31, 1989, all land devoted to agricultural use which is subject to the
21 federal conservation reserve program shall be classified as cultivated
22 dryland for the purpose of valuation for property tax purposes pur-
23 suant to this section. Productivity of land devoted to agricultural use
24 shall be determined for all land classes within each county or ho-
25 mogeneous region based on an average of the eight calendar years
26 immediately preceding the calendar year which immediately pre-
27 cedes the year of valuation, at a degree of management reflecting
28 median production levels. The director of property valuation shall
29 determine median production levels based on information available
30 from state and federal crop and livestock reporting services, the soil
31 conservation service, and any other sources of data that the director
32 considers appropriate.

33 The share of net income from land in the various land classes
34 within each county or homogeneous region which is normally re-
35 ceived by the landlord shall be used as the basis for determining
36 agricultural income for all land devoted to agricultural use except
37 pasture or rangeland. The net income normally received by the
38 landlord from such land shall be determined by deducting expenses
39 normally incurred by the landlord from the share of the gross income
40 normally received by the landlord. The net rental income normally
41 received by the landlord from pasture or rangeland within each
42 county or homogeneous region shall be used as the basis for deter-
43 mining agricultural income from such land. The net rental income
44 from pasture and rangeland which is normally received by the land-

1 lord shall be determined by deducting expenses normally incurred
2 from the gross income normally received by the landlord. Commodity
3 prices, crop yields and pasture and rangeland rental rates and ex-
4 penses shall be based on an average of the eight calendar years
5 immediately preceding the calendar year which immediately pre-
6 ceedes the year of valuation. Net income for every land class within
7 each county or homogeneous region shall be capitalized at a rate
8 determined to be the sum of the contract rate of interest on new
9 federal land bank loans in Kansas on July 1 of each year averaged
10 over a five-year period which includes the five years immediately
11 preceding the calendar year which immediately precedes the year
12 of valuation, plus a percentage not less than .75% nor more than
13 2.75%, as determined by the director of property valuation.

14 Based on the foregoing procedures the director of property val-
15 uation shall make an annual determination of the value of land within
16 each of the various classes of land devoted to agricultural use within
17 each county or homogeneous region and furnish the same to the
18 several county appraisers who shall classify such land according to
19 its current usage and apply the value applicable to such class of land
20 according to the valuation schedules prepared and adopted by the
21 director of property valuation under the provisions of this section.

22 For the purpose of the foregoing provisions of this section the
23 phrase "land devoted to agricultural use" shall mean and include
24 land, regardless of whether it is located in the unincorporated area
25 of the county or within the corporate limits of a city, which is devoted
26 to the production of plants, animals or horticultural products, in-
27 cluding but not limited to: Forages; grains and feed crops; dairy
28 animals and dairy products; poultry and poultry products; beef cattle,
29 sheep, swine and horses; bees and apiary products; trees and forest
30 products; fruits, nuts and berries; vegetables; nursery, floral, orna-
31 mental and greenhouse products. Land devoted to agricultural use
32 shall not include those lands which are used for recreational pur-
33 poses, suburban residential acreages, rural home sites or farm home
34 sites and yard plots whose primary function is for residential or
35 recreational purposes even though such properties may produce or
36 maintain some of those plants or animals listed in the foregoing
37 definition.

38 The term "expenses" shall mean those expenses typically incurred
39 in producing the plants, animals and horticultural products described
40 above including management fees, production costs, maintenance and
41 depreciation of fences, irrigation wells, irrigation laterals and real
42 estate taxes, but the term shall not include those expenses incurred
43 in providing temporary or permanent buildings used in the pro-

1 duction of such plants, animals and horticultural products.
2 The valuations established for tangible property under the program
3 of statewide reappraisal shall not be applied by any county as a basis
4 for the levy of taxes until January 1, 1989. The provisions of this
5 act shall not be construed to conflict with any other provisions of
6 law relating to the appraisal of tangible property for taxation purposes
7 including the equalization processes of the county and state board
8 of tax appeals.
9 Sec. 2. K.S.A. 1991 Supp. 79-1476 is hereby repealed.
10 Sec. 3. This act shall take effect and be in force from and after
11 its publication in the Kansas register.

KANSAS COUNTY APPRAISERS ASSOCIATION

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To: Senate Assessment and Taxation Committee

From: Larry Clark, President KCAA

Date: February 13, 1992

Mr. Chairman and members of the committee thank you for this opportunity to appear in opposition to Senate Bill 566. I appear before you on behalf of the Kansas County Appraisers Association as their president.

Senate Bill 566 requires county appraisers to utilize an income approach estimate of value that is not based on the market and without any regard given to the quality of that estimate or other estimates made through the cost or comparative sales approaches. In our opinion this would be a direct violation of the constitutional requirements for a uniform and equal system of assessment and taxation; it would not satisfy the definition of fair market value in 79-503a and would cause county appraisers in this state to violate Standard 6 of the Uniform Standards of Professional Appraisal Practice.

Standards Rule 6-4 states in appropriate part:

In developing a mass appraisal for ad valorem tax purposes, an appraiser must:

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- (a) value the site by an appropriate method or technique;
- (b) collect, verify, analyze, and reconcile:
 - (i) such comparable cost data as are available to estimate the cost new of the improvement (if any);
 - (ii) such comparable data as are available to estimate the difference between cost new and the present worth of the improvements (accrued depreciation);
 - (iii) such comparable sales data, adequately identified and described, as are available to indicate a value conclusion;
 - (iv) such comparable rental data as are available to estimate the market rental of the property being appraised;
 - (v) such comparable operating expense data as are available to estimate the operating expenses of the property being appraised;
 - (vi) such comparable data as are available to estimate rates of capitalization and/or rates of discount.

Every major appraisal organization has adopted this standard, including the Appraisal Institute and the International Association of Assessing Officers.

In The Appraisal of Real Estate, Ninth Edition, the official text of the Appraisal Institute, it is stated:

The income capitalization approach is one of three traditional approaches that an appraiser may use in the valuation process. However, it is not an independent system of valuation that is unrelated to the other approaches. The valuation process as a whole is composed of integrated, interrelated, and inseparable techniques and procedures designed to produce a convincing and reliable estimate of value, usually market value. (page 407)

. . . If a market value estimate is sought, the income forecast should reflect the expectations of market participants. (page 430)

. . . The appraiser estimates income and expenses after researching and analyzing 1) the income and expense history of the subject property; 2) income and expense histories of competitive properties; 3) recently signed leases, proposed leases, and asking rents for the subject and competitive properties; 4) actual vacancy levels for the subject and competitive properties; 5) management expenses for the subject and competitive properties; 6) published operating data; 7) market expectations; and 8) tax assessment policies and projected changes in utility rates. (page 438)

In its text Improving Real Property Assessment the International Association of Assessing Officers describes the objective of the income approach in the following terms:

. . .The market value of an income-producing property is the expected sale price of the property under the assumption of typical financing and rent. The concept presumes that parties to the sale are rational, knowledgeable, and eager to come to agreement, although under no undue pressure to do so. The assumption of typical financing and rent make explicit that market value relates to the intrinsic nature of the property itself and is independent of atypical financing or rental arrangements. Specifically, market value is not affected by the ability of a purchaser to assume a mortgage at a favorable rate of interest, by the willingness of a seller to extend financing when a lending institution would not, or by the existence of a dated and atypical lease arrangement. While these factors will affect the expected sale price of the property, they should not be interpreted as affecting market value. The assumptions of typical financing and rent allow the assessor to focus on the intrinsic income-producing capability of properties and avoid the complications associated with individual financial and lease arrangements.(page 254)

This same reasoning is repeated in IAAO's latest text, Property Appraisal and Assessment Administration:

The appraiser estimates the income stream that would be produced in the highest and best use under typical management. The property, not current management, is being valued; therefore, it is proper to assume that the potential investors would use the property for its most profitable legal use, and the buyer would employ typical rather than extraordinary management.(page 84)

Line 43 on page one of this bill requires the appraisal to establish the value for improved commercial real property according to its income earning capacity. Yet it contradicts that on page two by requiring the appraiser to utilize actual rent income and expense information provided by the owner. As implied by the preceding paragraph this would amount to valuing the owner's management ability, rather than the intrinsic value of the real estate. If the owner is a poor manager and therefore

produces a less than typical net income on the property, the ultimate value estimate will be lower than a typical manager. The reverse is true of the good manager who would be penalized by a property tax based on his or her management skills instead of the value of the property.

The latter circumstance is in direct violation of the Kansas constitution for it provides a situation where two or more properties, identical in every respect except for the management would receive different values and, as a result, different assessments. Contract rents and expenses have to be examined before the typical rent and expense levels can be established. However, just as one sale should not be used to establish the market, neither should one income and expense statement.

On line 30 of page 2 of the bill appears the requirement that the county appraiser allow as an operating expense "all ad valorem taxes assessed to the property in the preceding year." This also violates accepted appraisal practice as spelled out in the text Property Appraisal and Assessment Administration:

Because any deduction from gross income affects value in the income approach, only typical and reasonable expenses can be deducted in calculating net operating income. When property is valued for ad valorem tax purposes, therefore, property taxes cannot be shown as an operating expense because the actual taxes are not known as of the assessment date. Indeed, the appraisal is often done to estimate the amount of tax. The problem can be resolved by developing an effective tax rate and including it in the capitalization rate for the subject property. (page 287)

Every responsible county appraiser in the state realizes that problems of equity and fairness exist in the current system and they are actively involved in resolving them. The valuation of commercial property is especially troubling since the unit

values are typically higher than residential and tax shifts of 1989 struck that class harder. More problematic from the appraiser's standpoint is the lack of good information to develop an income approach as a direct result of the unwillingness of property owners to provide it. A better amendment to 79-1476 may be to require owners of income-producing property to file income and expense statements with the county appraiser's office on an annual basis. With that information responsible appraisers can perform the necessary analysis to develop a sound income approach estimate where it is applicable.

This bill can only be supported if and when Kansas abandons the goal of fair market value.