Division Of Property Valuation
Docking State Office Building
915 SW Harrison St., Room 400N
Topeka, KS 66612-1588

Kansas Department of Revenue

phone: 785-296-2365
fax: 785-296-2320
www.ksrevenue.org

Nick Jordan, Secretary
David N. Harper, Director

Sam Brownback, Governor

TO: Representative Marvin Kleeb, Chairman
House Standing Committee on Taxation

FROM: David Harper, Director
Kansas Division of Property Valuation (PVD)

DATE: March 8, 2016

SUBJECT: House Bill 2714

House Bill 2714 as introduced contains sixteen sections which to varying degrees amend numerous aspects of the ad valorem property tax appraisal and appeal process.

<u>Section 1</u> moves the appraisal process to a two-year cycle beginning with the January 1, 2017 year.

With approximately 1.6 million real estate parcels, plus personal property and oil and gas personal property to appraise each year, moving to a biennial appraisal process does benefit counties by lessening the annual workload and allowing time to work through a more detailed review of property appraisals.

Other states conduct reappraisals on a multi-year basis. An April, 2010 report from the Tax Foundation shows the following reappraisal cycles for the 50 states.

Reappraisal Period	# of States	% of States
One Year Cycle	11	22%
Two Year Cycle	6	12%
Three Year Cycle	7	14%
Four Year Cycle	7	14%
Five Year Cycle	7	14%
Six Year Cycle	2	4%
6 year + Cycle	2	4%
No Provision	8	16%

In Kansas, moving to a two year appraisal cycle would be a major change. As the agency tasked with oversight of the administration of the Kansas property tax system, PVD requests the opportunity to identify all statutes related to the annual reappraisal cycle and propose revisions to add clarification on all related tasks and procedures.

Unanswered from the current draft are references of annual classification, requirements for annual taxpayer filings for personal property and oil and gas property, the oil and gas valuation process, the appeal process, the annual requirements for public utilities to file a return with PVD, annual exemption reporting requirements, correction orders and clerical errors, calculations of prorated taxes on personal property and other procedures embedded in the annual reporting, classification, valuation, notification and appeal process in our current annual cycle.

Most of these will likely be fairly simple fixes, addressing administrative and procedural issues. However, they should be addressed in a plan to move to a biennium reappraisal cycle.

A primary concern with the bill as written is classification and physical changes to the property after January 1. As written, Section 1 only addresses the "valuation established for property." Classification needs to be addressed along with valuation.

My understanding of Section 1 of HB 2714 is market value for all property will be established as of January 1 of the first year of the biennium. Improvements will be added at some point in the biennium, though an effective appraisal date is not established for the improvement values, or is a definition of improvements. There is a concern if establishing two separate appraisal dates for the same class of properties complies with the "uniform and equal basis of valuation" provision of Article 11 of the Kansas Constitution. Many states that rely on a multi-year valuation cycle also have implemented equalization procedures to allow needed changed in value on the off years. These procedures are typically managed at the state level and based on the results of sales ratio studies.

<u>Sections 3,10 and 11</u> focus on the principles of mass appraisal vs. single property appraisals. Through conversations with proponents of HB 2714, it is my understanding at the formal appeal levels for commercial properties, they are seeking assurance the county is recognizing the impact on value of the individual subject property characteristics, and a requirement the county will produce a written individual appraisal of each property detailing the property specific process and adjustments applied to arrive at the final opinion of value.

Section 3 amends K.S.A. 2015 Supp. 74-2433(g) to include *Valuation appeals before the board shall not be decided upon whether or not the mass appraisal of the property was done correctly, but upon a determination of the fair market value of the fee simple of the property;*

Section 10 removes "mass appraisal" from K.S.A. 2015 Supp. 79-503(k) in the following *The appraisal process utilized in the valuation of all real and tangible personal property for ad valorem tax purposes shall conform to generally accepted appraisal procedures which are ~~adaptable to mass appraisal and~~ consistent with the definition of fair market value unless otherwise specified by law.*

Section 11 addresses the definition of a written appraisal in K.S.A. 79-504 by removing the provision for computer assisted mass appraisal reports to be deemed as a written appraisal. "*Written appraisal" means a written statement used in connection with the activities of the division of property valuation or a county appraiser that is independently and impartially prepared by a county appraiser setting forth an opinion of defined value of an adequately described property as of a specific date, supported by presentation and analysis of relevant market information. ~~Appraisals produced by the computer assisted mass appraisal system prescribed or approved by the director of property valuation shall be deemed to be written appraisals for the purposes of this act~~.*

I have discussed these changes with proponents of HB 2714 and question if these changes accomplish their goal? Is the requirement for a written appraisal at BOTA clear in these changes?

My understanding of the intent is not to eliminate the use of mass appraisal for ad valorem tax purposes, but to improve the reporting process and clearly state the appraiser must consider the individual characteristics of the each property. That is a reasonable change if the revisions to statutes could not be interpreted to disallow mass appraisal.

Mass appraisal techniques are needed in ad valorem property tax appraisals. Mass appraisal is an accepted practice and part of the Uniform Standards of Professional Appraisal Practice, (USPAP). The principles which are listed in USPAP for the development of a mass appraisal mirror those of the development requirements for a single property appraisal.

Mass appraisal requires accurate listing and recognition of the impact on value of individual property characteristics. This is further specified in K.S.A. 79-503a which requires consideration of:

> *(a) The proper classification of lands and improvements;*
> *(b) the size thereof;*
> *(c) the effect of location on value;*
> *(d) depreciation, including physical deterioration or functional, economic or social obsolescence;*
> *(e) cost of reproduction of improvements;*
> *(f) productivity taking into account all restrictions imposed by the state or federal government and local governing bodies, including, but not limited to, restrictions on property rented or leased to low income individuals and families as authorized by section 42 of the federal internal revenue code of 1986, as amended;*
> *(g) earning capacity as indicated by lease price, by capitalization of net income or by absorption or sell-out period;*
> *(h) rental or reasonable rental values or rental values restricted by the state or federal government or local governing bodies, including, but not limited to, restrictions on property rented or leased to low income individuals and families, as authorized by section 42 of the federal internal revenue code of 1986, as amended;*
> *(i) sale value on open market with due allowance to abnormal inflationary factors influencing such values;*
> *(j) restrictions or requirements imposed upon the use of real estate by the state or federal government or local governing bodies, including zoning and planning boards or commissions, and including, but not limited to, restrictions or requirements imposed upon the use of real estate rented or leased to low income individuals and families, as authorized by section 42 of the federal internal revenue code of 1986, as amended; and*

To address the areas of concern in Sections 3, 10 and 11 we suggest reference to USPAP Standards and K.S.A. 79-503a.

Mass appraisal does result in a single property value and a written report explaining the valuation results can be produced and is a reasonable request to help the taxpayer understand the valuation process. In-fact, there is confusion on what constitutes a USPAP compliant mass appraisal report for a single property, and a question if USPAP even addresses reporting the results for a single property valued through mass appraisal techniques. Providing in statute a written summary report of the results for a single property is required could be helpful. Language though in HB 2714 which could be construed to mean mass appraisal techniques are unacceptable would have major implications for the administration of the appraisal process for ad valorem property tax purposes.

We would also request consideration be given to limiting the requirement for written reports to appeals of commercial properties. As shown by actual appeal numbers, the majority of appeals at the formal level are residential properties. Our system is capable of producing appeal packets for residential property which have been well accepted and understood by property owners. Based on the concerns of the proponents of HB 2714, it would seem appropriate to focus only on the reporting process for commercial properties at this time.

	Parcel Count		Equalization (County Level)			BOTA		
Property Class	Parcels	% of Total Parcels	# of Informal Appeals	% of Class Appealed	% of Total Appeals	# of Appeals	% of Class Appealed	% of Total Appeals
Residential	922,686	57.24%	9,618	1.04%	53.67%	2,061	0.22%	11.50%
Agricultural	326,749	20.27%	2,219	0.68%	12.38%			
Vacant Lot	124,545	7.73%	1,378	1.11%	7.69%			
Farm with homesite	92,516	5.74%	999	1.08%	5.58%			
Commercial/Industrial	74,392	4.62%	3,601	4.84%	20.10%	526	0.71%	2.94%
Exempt	62,002	3.85%						
Other	3,826	0.24%	17	0.44%	0.09%			
Not for Profit	809	0.05%	87	10.75%	0.49%			
Public Utilities	4,417	0.27%						
Total	1,611,942		17,919	1.11%		1,967	0.12%	

Sections 4 and 14 contain provisions requiring appraisers to follow PVD valuation guides and methodologies. BOTA statute K.S.A. 2015 Supp. 74-2438 is amended in Section 4 of HB 2714 to include *With regard to any matter properly submitted to the board relating to the determination of valuation of real property, if the director of property valuation has developed and adopted methodologies to value such type of property, then it shall be the duty of the county or district to demonstrate compliance with such methodologies. If the appraiser fails to demonstrate such compliance, then the board shall award judgment in the matter to the taxpayer.*

Appraisal statute K.S.A. 79-1456 is amended in Section 14 to include the statement *If the director has developed and adopted methodologies to value specific types of property, the county appraiser shall be required to follow such methodologies.*

Valuation guides for unique and complex properties are beneficial and we have targeted several property groups for which to develop guides. We support this idea but do need to implement rules and regulations so all interested parties have the opportunity to consult on the development before guides and procedures are finalized. It would be reasonable to include a provision in the sections requiring PVD to establish rules and regulations. The cost of contracting with appraisal experts for unique properties is the primary area of concern.

Section 5 amends K.S.A. 2015 Supp. 74-2438a to include *For any property valuation appeal to the board in which a filing fee is charged to a taxpayer, a filing fee of an equal amount shall also be charged to the county where the subject property is located.* For real property, single-family residential property is exempt from the filing fee. For most other real property, the fees range from $100 to $200 for the Small Claims Division and $125 - $500 for the Regular Division. As written, HB 2714 would include appeals by public utilities of their state appraised value and of agricultural land valuations also set at the state level. A fee to the counties should not apply for hearings of state assessed property.

Section 7 of HB 2714 adds to K.S.A. 79-309 *In no circumstance shall a change in the property occurring after the first day of January of any year be used to value the property as of the first day of January of such year.* In my opinion this is clear in current statute, the effective appraisal date is January 1. Physical changes to a property after January 1 shall not be considered in the appraisal until the following year. This is a basic principle which to my knowledge is being applied. If there is a need to address this, the revision should not be included in K.S.A. 79-309, as this is a personal property statute. This revision also may need to be modified if a biennium appraisal cycle is implemented.

Section 8 addresses the allocation of value following a "split" of a single parcel to multiple parcels or a "combination" of multiple parcels to a single property after the effective appraisal date. With a split or combination, taxpayers need an allocation of value for each parcel. This is a service counties provide, but K.S.A. 2015 Supp. 79-425a does not provide guidance on the time frame which these splits and combinations may be worked. We would like to work with the proponents of HB 2714 to add even more clarification in this statute. This should be an automatic procedure by the county, but it often involves the register of deeds, the county clerk, the county treasurer and the county appraiser, and we should include clear procedures in statute.

Section 9 includes two amendments to K.S.A. 79-501. *(a) Each parcel of real property shall be individually appraised at its fair market value in money* and *(b) For the purposes of determining the value of an individual parcel of real property, the county appraiser shall not consider the parcel as an economic unit with any adjoining parcel.*

It is again my understanding the intent with adding "individually" is not an attempt to disallow mass appraisal. However I do think strict interpretation of this language could lead to the conclusion individual property values cannot be arrived at through the application of acceptable mass appraisal techniques. If I am correct in understanding the proponent's intent, we will offer suggestions for clarifying language.

I believe the intent with the addition of the word "individually" to section (a) of 79-501 is for it to be applied in conjunction with section (b) as related to the use of economic units. This is a change we have discussed with the proponents to make them aware of potential unintended consequences. It is common for the use of an economic unit to result in a lower value for a parcel than if the parcel were valued individually. Economic units can be a valid appraisal method which often benefits the property owner.

Sections 13 and 15 contain revisions to policy for the classification of land devoted to agricultural use. Section 13 adds to K.S.A. 2015 Supp. 79-1448 (equalization appeal statute) that *In any appeal from the reclassification of property that was originally classified as land devoted to agricultural use, the taxpayer's classification of the property as land devoted to agricultural use shall be presumed to be valid and correct if the taxpayer provides an executed lease document demonstrating a commitment to use the property for agricultural use.*

There is concern reliance solely on a lease for a commitment to agricultural use qualifies for the agricultural use classification. I do not believe this is the intent of the proponents but instead the intent is to protect the agricultural classification of a parcel already devoted to agricultural use when the use may not be clearly determined as of January 1 of the next appraisal year. I believe this is the approach most counties take now in the annual review process.

Section 15 clarifies in K.S.A. 2015 Supp. 79-*1476 If a parcel has land devoted to agricultural purposes and land used for suburban recreational acreages, rural home sites or farm home sites, the county appraiser shall determine the amount of the parcel used for agricultural purposes and value it and assess it accordingly as land devoted to agricultural purposes. The county appraiser shall then determine the amount of the remaining land used for such other purposes and value that land and assess it according to its use.*

This addition clarifies what PVD has supported for a mixed use classification and what I believe is now the practice in all counties. This addition would add protection to current practice pending a decision in current litigation involving this matter.

Sections 13 and 16 include additions to statutes stating *Prior to the informal meeting, the county appraiser shall prepare and deliver to the taxpayer a written narrative and summary of the reasons that the valuation of the property has been increased over the preceding year. Such summary shall include any assumptions used by the county appraiser to determine the property's value.*

This again involves a request for more detailed explanations of the valuation process. Currently K.S.A. 2015 Supp. 79-1448 addresses the production of evidence at an informal hearing by stating *At such meeting it shall be the duty of the county appraiser or the county appraiser's designee to initiate production of evidence to substantiate the valuation of such property, including the affording to the taxpayer of the opportunity to review the data sheet of comparable sales utilized in the determination of such valuation*.

This current language of K.S.A. 2015 Supp. 79-1448 could be modified to reference evidence pertaining to commercial property. Currently, referencing only a comparable sales sheet in the statute narrows the requirement to produce documentation to residential property valued through the sales comparison approach. It is my belief county appraisers realize the benefit of the production of evidence at the informal hearings and strive to reach a fair agreement on value at the local appeal level. Clarifying the documentation which a taxpayer could expect to receive and discuss at an informal appearing is valid and a superior option to requiring mailing of the documentation prior to the hearing.

Section 16 also amends K.S.A. 2015 Supp. 79-2005 to prevent the distribution of funds related to a payment under protest appeal. Payment under protests may be filed with the first half payment on or before December 20, or "at the time of paying such tax." Delinquent payments may be paid under protest and according to the revisions in Section 16 of HB 2714, these funds could not be distributed.

It is my understanding the purpose of this change is to add additional incentives for the county to timely process the appeal. Based on the current statues regarding distribution of funds by county treasurers, perhaps applying this change to the first half payment under protests only is reasonable. This would provide the incentive to resolve protests based on timely payments and prior to the first distribution of funds.

Thank you for your time and consideration of the contents of HB 2714. We appreciate the opportunity to continue to work with all to assure changes which benefit the overall administration of the property tax system in Kansas.