

Webinar 5: Residential & Commercial Real Estate Property Assessments

Hosted by Wayne Miller, Professor at the University of Arkansas System Division of Agriculture and presented by Billy Smothermon, Division Administrator-Field Operations, Arkansas Assessment Coordination Department on August 3, 2018

[Wayne Miller] Good morning and welcome to the Residential and Commercial Real Estate Property Assessment Webinar.

I'm Wayne Miller, Professor with the Community and Economic Development Program of the University of Arkansas System Division of Agriculture. And right beside me is Billy Smothermon, who is Division Administrator for Field Operations for the Arkansas Assessment Coordination Department.

This is the fifth in the series of property assessment webinars and it's part of our local government program. We're doing this in collaboration with the Arkansas Assessment Coordination Department and the Tax Division of the Arkansas Public Service Commission.

As we've discussed in the past the property tax, which is based on property assessments, is a local tax supporting local services. Most all of us pay the property tax, either directly or indirectly, and we all benefit from the services funded in part by the property tax. Whether it's our K through 12 schools, our county and city roads and bridges, our local fire and police departments, and many other services like our recreation program and facilities, agricultural services, healthcare services and many more.

Before we get into the presentation today, I'd like to just briefly review what we've covered in some of the past assessment webinars.

The first webinar was an overview of property assessments: what property is assessed and then the assessment process.

In the next webinar, we had a presentation on agricultural and forestry land assessments. Now, we can see from this beginning of the pie chart, that agriculture was assessed about the \$3.1 billion in this is in 2015 or about 7% of total assessments. Now, this may be a little bit different than was presented by Rob McGee in his presentation, because this includes land and buildings. I think he talked about primarily land assessments.

Our next webinar was on personal property assessments and these can be divided into business, auto and a small amount of other personal property assessments. And combined, this is about 22% of the assessments in 2015.

This was followed by a presentation on utilities and carriers, and utilities and carriers can contribute about 8% of the assessments in Arkansas.

Minerals, which we haven't covered, is about 2% of total assessments in the state of Arkansas.

And today we're going to cover Residential and Commercial Real Estate Property Assessments, and you can see what's left here: combined its about 61% of your property assessments in Arkansas.

So I'd like to welcome Billy at Smothermon today for the presentation. He has been designated by the Arkansas Assessment Coordination Department as a level four senior appraiser and appraisal manager. He is an accredited member of the International Association of Assessing Officers.

Billy has spent 10 years in the field as a county appraiser, working first for a reappraisal contractor and then spending eight years with White County assessor's office in Searcy. In January 2015, he came to the Assessment Coordination Department to lead the Field Operations Division and a team of 18 field staff who conduct performance audits on the operation of the 75 assessor's offices statewide.

While working for White County, he served as a member of the Arkansas agriculture and GIS best practice group and continues to work with the assessment best practice groups to improve property assessments in the state.

In addition to overseeing the functions of the audit, he also develops or makes adjustments to certain appraisal and valuation guidelines, assists assessors or appraisal contractors with compliance questions and consults in the development of reappraisal plans for some counties.

We're fortunate to have Billy with us today and we look forward to your presentation.

[Billy Smothermon] Thank you, Wayne.

Good morning, I appreciate everyone tuning in to this webinar and look forward to informing and spreading information about how real estate assessments are conducted in the state of Arkansas. So, I'd like to approach this as a series of questions and answers that get us to an end result of knowing more about the system.

So, the first question we might ask ourselves is, why does the county assessor appraise real estate? Property appraisal is one of the statutory duties of the county assessor. Arkansas Code Annotated 26-26-1902 states that each county in the state of Arkansas is required to appraise all of the real estate normally assessed by the county assessor at its full market value. Elsewhere in the statute, it defines what is normally assessed, that being real estate, both residential and commercial, personal property and other types of property.

So then we might ask ourselves, well, okay, so the assessor has to appraise real estate, what is real estate? I think we all have a basic definition of what real estate is, but for assessment purposes, real estate is composed of the land (both agricultural and market value).

Primary (structures dwellings, commercial buildings). The primary structure on the property. Secondary structures: outbuildings, farm buildings, those type of things. And other improvements: paving, fences, signs, [and] pools. Basically, anything that can be constructed upon the land is accessible by the county assessor.

So, they must appraise property at its fair market value. So let's define appraisal. An appraisal is an estimate of value of a property in terms of money.

The one we're most familiar with, single property appraisal, is the systematic appraisal of property at a given time. So, this is mostly made up of what we call "fee appraisals," these are conducted by individual appraisers on individual properties, typically for bank purposes, for estate purposes...and they take a different level of property detail into consideration, and the appraisal is developed somewhat differently from mass appraisal.

Mass appraisal is what we conduct for county taxation purposes for assessment. Mass appraisal is valuing and group of properties, as a given date, using standard methods, employing common data and allowing for statistical testing.

So, a definition of market value is the most probable price, in terms of money as of a specific date, which property should bring in a competitive and open market under all conditions requisite to a fair sale. The buyer and seller being typically motivated, each acting and knowledgeably, and assuming the price is not affected by undue stimulus.

So, the assessor is charged with appraising property at market value. Of course the assessor doesn't do this themselves, they employ professional appraisers to perform the appraisals for them.

So, we might ask, how do appraisers then arrive at market value? There are three approaches to arrive at market value.

The first, the sales comparison approach, is defined as deriving an estimate of value based upon sales that have occurred in the market, comparing properties of the same marketed unit, of similar attributes, similar use and similarly situated.

The second approach, the cost approach, is deriving the estimate of value based upon the current constituent cost less depreciation of an identical replacement or acceptable substitute with like utility.

The third approach, the income approach, is deriving an estimated value based upon the income, less allowable expenses of similar properties with similar use. Obviously, the income approach is only useful on income producing properties, and as such is used primarily for commercial, industrial properties, where income is available to be used to derive the value.

So then, mass appraisal of real estate is compiling all the available, relevant data in an organized and accurate manner necessary to produce a reliable estimate of market value. Obviously, we're having to appraise properties that have not sold, using properties that have sold.

So we're attempting to estimate the market value of things, based upon the market value of other items. The data is assembled based upon characteristics of similarity and dissimilarity.

So then, what types of data are we talking about? The types of data compiled depend upon what is available, and it will determine the appraisal approach used.

Costs data. So, we might look at construction type, quality rating measures and how the property is going to be used. Oftentimes, how the properties being used, and primarily with commercial property, determines what elements have gone into the property. For instance, a medical office compared to regular office. A medical office or a dental office, you're going to have more electrical, plumbing and things like that that have to go into it to serve the needs of a medical or dental office as compared to your regular, just standard office. So, we look at those things to help us determine the cost of the property.

Sales Data. Of course, sales prices, locations, property types and land. So, the land, we would look at both vacant and occupied improved land to determine a land value after it's sold. The property types, obviously we don't want to compare properties that are dissimilar. So, you're not going to use a sale of an office to help establish the market value of a warehouse.

Locations, as we know, for real estate: location, location, location, is the most important thing to, especially residential and commercial real estate. Commercial, both for its location and being accessible to customers. Also, homes, based upon school district or the most desirable

neighborhood. And we would also look at the sales prices to compare those among similar properties.

Income data. We would look at income, expenses and use and property types. Again, we don't want to compare the income from an apartment to an office, because they are dissimilar properties, and we would also look at the allowable expenses that can be deducted from the income to allow for that.

So, let's find out how land is assessed. First off, agricultural land is assessed based upon use value, we discussed this in ACD webinar 2. Rob McGee covered how agricultural land is valued. Market value land is assessed based upon a market derived value. These are typically split into residential land, commercial land and industrial land.

Residential land typically sells, and therefore is assessed, based upon lot or acreage, depending upon what's applicable. Commercial land typically sells either by square foot, front foot, lot or acreage. And industrial and often sells by lot or acreage, depending on where it's located.

So then, some land characteristics. We've talked about lot. Lot, the size of varies, but it's usually valued based upon a base lot typical to the market, with other sizes adjusted from base. So, for instance, if you have a subdivision that's typically made up of quarter acre lots, but you have one lot that's a third of an acre. Obviously, the value would be a little bit more, so that would be adjusted from the typical base lot value observed in the sales comparison approach.

Acreage: land that sells per acre will typically be assessed per acre used for residential, commercial or industrial buildings.

Acreage is typically used for residential property in rural areas and lot is more common in the city. Square foot is typically unit used for commercial development. Land is often sold by square foot and is also typically assessed by square foot.

And also front foot. Front foot is a common unit used in older downtowns or high traffic areas, where frontage is important to value. Obviously front foot wouldn't be applicable in an industrial park or often even in office park where the only folks visiting the office or the employees. This is something that is more important to retail businesses or things that are that rely upon traffic.

Some building characteristics we would look at: Square footage is the most common area of measure for a building. When you go to purchase a home oftentimes you're going to look at the square footage. Oftentimes, the price is expressed as a price per square foot.

Wall height is applicable in commercial, industrial applications and can determine be a determinant of the limitations of a property. Obviously, an office building typically has 10 foot walls, a warehouse with 10 foot walls wouldn't be very useful. So if you had a warehouse that was under height, it might have some obsolescence because of its limitations.

Occupancy is also used in commercial, industrial applications. As we've talked about, buildings are often built to suit and for particular use. Grade is a measure of type and quality of construction and we'll be discussing more about grade shortly.

Remaining economic life or effective age. Obviously, we in the government love to abbreviate things, so REL, remaining economic life, or effective age. It's a condition rating based upon the typical economic life of a particular grade of structure and captures the depreciation. So the remaining economic life, is based upon the expectation that a particular type of structure will last for a particular period of time. That the depreciation can be captured by stating how much of that structure's total economic life is remaining.

As appraisers we used to cost manuals and CAMA software to help us develop cost for structures. Cost manuals, books in hand, are the old way of doing things, and we do still occasionally find use for using those manuals. But for the most part, nowadays, we are using CAMA software and have for several years now. And the data that's contained in the cost manuals is loaded into the CAMA software. CAMA stands for "Computer Aided Mass Appraisal."

So, that allows us to digitally access the information that would normally be contained in the cost manual. These manuals and software, we use them to assign a fixed cost per unit, based upon: building use, construction type, construction quality, size, story height, interior finish and other improvements.

So then let's discuss some residential buildings and talk about quality of construction and condition. In the state of Arkansas, we have a wide range of qualities of construction of residential buildings. From the highest of residential homes to the lowest of basic shelter.

So then we discuss building grade. As we've discussed grade has to do with the quality of construction of the building. In the state of Arkansas, we have seven residential grades, D1-D7, D1 being the highest quality architecturally designed. As the first picture I showed you a moment ago.

Here's an aerial view same dwelling, and as you can see, this is a very impressive home, designed by an architect, built to the highest quality, using the highest quality materials and suited for the highest tier in the market.

Second, we have D2. This is also very high quality, semi-custom designed. So, this might be similar to the home that's a D1, but there are fewer custom elements, it's not necessarily architecturally designed. It is designed from plans with some custom elements.

D3 is higher quality speculative homes. Some customized elements. This is often what we see today in new residential developments: higher quality speculative homes. So, speculative, being built by a developer to build out a subdivision. There will be some customized elements. Often, these homes in new subdivisions sell with the purchaser having the option to pick out cabinets, bathroom fixtures, carpet, other floor coverings, paint colors, etc. So there, there's still a wide range of elements that can be customized in these homes, but they are more standardized.

The D4 is a basic quality speculative home, average cookie cutter plans. This is what we like to think of as a benchmark structure. So, an example of that might be what we all think of most commonly when we think of normal residential neighborhoods. Particularly popular in the 1960s, through the early 90s, also referred to as a ranch home. This is the most common, or the benchmark, residential structure.

D5 lower quality speculative homes, low cost cookie cutter plans. So, this might be in a more economically depressed area. These aren't built on a broad base basis nowadays, but if you're in an area that has former military bases, a lot of times the subdivisions around those were built with D5 houses.

D6, substandard quality built only for utility with little regard to resale. So these are the most basic structure, the most basic shelter, what we might consider home built. Built simply for the use of the person who constructed it.

And we also have D7, which in and of itself isn't really a building grade, but it is used by appraisers to value properties for salvage purposes. So, properties that have been damaged or basically have very little value due to disrepair, typically less than \$6 a square foot.

So, the second photo of the residential dwellings that we saw on our title slide earlier. This might be considered, depending on the appraiser in their opinion of the value, to be either a D6 or D7. It is the most basic shelter and this structure is appraised in the state of Arkansas as a as a dwelling. This is a residence. The county where this is located has it appraised as a D6, substandard quality for the most basic of shelter.

So then let's discuss residential exterior type. Obviously, each type of grade can have a different type of exterior and how the exterior is constructed has directly to do with value. So, first we, as appraisers, look at low cost frame, the cheapest siding materials, plywood, shingle, that type of thing.

Standard frame, average siding materials, vinyl, board, this is your standard frame house siding.

Masonry veneer, average siding materials, brick, stone.

Combo masonry frame. This takes into account structure that is half and half, both frame siding and brick.

Specialty homes covers log homes, underground and A-Frame structures, and basically is a catch all to help us for properties that not typically constructed, to capture their value.

Other value related items we might consider: type of foundation, floor structure, heat and air, and the list goes on and on.

Let's discuss commercial buildings. From the highest grade of commercial building, Stephens building downtown in Little Rock, to the most utilitarian and basic of commercial structures, all have to be valued as commercial property. So, the building grade on commercial is what we call commercial class.

It is defined by the exterior and the frame of the structure.

The Cass A building, as illustrated with the Stevens billing here, structural steel frame non-combustible is the highest class of commercial structure. Typically seen in high rises, that sort of thing.

Class B, also in the high rise or low rise office construction, reinforced concrete frame, fire resistant. Class C, concrete, load bearing walls, fire resistant. Class D, wood or light steel, combustible. Class S, light steel frame, fire resistant. Within each of these classes, there are quality ratings, from excellent, good, average to low cost.

Commercial occupancy is important to value and is based upon the use of the building. As we've discussed, the occupancy: office, medical, retail, restaurant, warehouse.

How the building is used has directly to do with how it's constructed, because typically, commercial structures aren't built in such a way to convert their use. Occupancy also defines the interior finish and the depreciation schedule for the structure.

Outbuildings, yard improvements, and lump-sums are common to both residential and commercial structures, and can include a variety of things that are separate from the primary structure, but are important to value.

So then mass appraisal of real estate is combining all the data into reliable estimate of value. So let's take a closer look at one example.

We've already seen this house once, this is our D4 example. It has a height of one story, built in 1962, masonry, asphalt roof, central heat and air, one full bath one half bath. This is a basic D4 residential structure.

So, we count all the elements that constitute the structure. When the appraiser takes the measurements, they measure and separate living area, heated and cooled area, from other elements that constitute the exterior of the structure.

From our CAMA software, we enter the measurements and determine the total cost is \$100,000. When the appraiser was in the field, they observed the depreciation at about 20%, so we now know that our cost less depreciation is \$80,000.

In the market area in the neighborhood that this house exists, we have also conducted sales analysis. So we know that our cost of the subject property is \$80,000. When we conduct sales analysis, we're comparing the estimated cost of the structure, based upon the individual elements that have been listed within the structure, against the recent sales price of the house, less land, to help us develop a market factor.

So in this first sale, we see that our cost is \$79,000. We have had a recent sale, less land, of \$94,000, which gives us a factor of 1.19. As we go down the list, we calculate the market factors for all five of the sales that occurred in this neighborhood and have determined that our average market factor for this neighborhood should be 1.2. So then let's discuss the formula of an appraisal.

An appraisal is: building replacement costs (from the cost approach), minus depreciation (estimated from direct observation by the appraiser), times the market factor (derived from sales analysis). That equals the full improvement value, plus land value (taken from the sales comparison approach), equals full market value. This is the basic model for an appraisal.

So, given our sample appraisal, we can see the calculated cost of the building is \$100,000, less the depreciation, gives us the replacement cost new of \$80,000. At our market factor that we have derived, gives us a full improvement value of \$96,000. Plus the land, taken from the sales comparison approach, gives us a total appraised value \$106,000 for our D4 home.

So then discussing the formula of an assessment. We have our appraised value. We multiply that in the state of Arkansas times 20%, that is called our assessment level, we assess all property, whether agricultural, residential real estate, commercial, personal, at 20% of its

appraised value. This equals the assessed value. Multiply that by the local millage rate, equals the property tax. And if the property is homesteaded, less up to a \$350 homestead tax credit.

So then let's look back at our example. So a sample assessment would be, our total appraised value, at the assessment level of 20%, gives us a full assessed value of \$21,200. At our state average millage—so this is for example, and obviously your millage is going to be different where you live—gives us a total tax of \$975.

This property is homesteaded, and the total value of the property tax is greater than the homestead credit, so they do not qualify for their whole \$350 tax credit, gives us a total tax due of \$625.

So, then we have a few questions. First of all, some common questions we receive, how do I assess my property? So, property owners should report any new buildings, or changes to existing buildings, to the county assessor. During the course of the re-appraisal in a three to five year cycle, any previously undiscovered property will be listed. The assessor makes changes of ownership in real property according to properly recorded deeds. The assessor assesses real property annually to the owner of record.

We also received the question, when do I pay my taxes? So, property taxes that are currently due, are payable to the county collector by October 15th of each year. In the state of Arkansas, we pay one year in arrears, so the taxes that are due this October 15th are the taxes that were assessed for 2017. Partial payments are generally accepted up to the deadline, your county collector can provide you with further details.

The biggest question, I think, is how do I appeal my assessment? If it anytime you disagree with your assessment or think there's inaccuracies in your record, first check with your county assessor. If there's errors in property details, those can often be corrected without further appeal. Oftentimes folks have disagreements about the value of their property and don't realize that the problem with the value is actually that there's errors in the property detail. Those things that are measurable in the property, and oftentimes those can be corrected.

If it does come down to simple, just a basic difference of opinion of value, and for more substantial assessment appeals, an appeal can be scheduled with the County Board of Equalization up to the third Monday in August.

Wayne, do we have any additional questions?

[Wayne Miller] Yes, we have several questions, Billy.

First question for you, Billy, is what is a homestead and what does it cover?

[Billy Smothermon] So, I have some visuals to help us understand what a homestead is and what it covers. So the homestead is a property tax credit of up to \$350. You may apply at your county assessor's office for homestead and the disabled or 65 plus freeze. In the state of Arkansas, if you're disabled or over the age of 65, you may be entitled to a freeze to the value of your homesteaded property. The homestead applies to the home you own and in which you reside and the land and other buildings associated with your home and maintained at your homesite. So let's take a look at an example of a fall small farmstead.

So here we have a small family farm. At the bottom center of the image, you'll see there's a dwelling with a gray roof, and there's a light gray roof next to it that's a mobile home that the owner of the property rents for extra income.

So then the buildings in the back, those are all farm buildings, those are barns and sheds and other things that are associated with the farm, but not associated with the owners homestead. So as far as the land, we would have a two acre house lot, homesteaded. The outbuildings and yard improvements are mostly farm buildings, they're non-homesteadable. So those buildings wouldn't be included in the homestead, but the dwelling and its two acre house lot would.

Next door, the mobile home, is non-homesteadable, because it's not the owners primary place of residence. And additionally, the associated acre house lot is also non-homesteadable. And of course the agricultural land surrounding it, varying uses and soil codes, the agricultural land is non-homesteadable.

[Wayne Miller] Okay, second question is, how often is a county-wide reappraisal conducted for real property?

[Billy Smothermon] So, the county wide reappraisal is conducted every three or five years, per statute in the state of Arkansas. Currently, since 2013, there have been no three year counties. There are benchmarks established in statute as to how county either arrives on the three year cycle or comes off of it. Currently, all counties in the state of Arkansas are on a five year cycle. And on your screen you'll see an example of counties by year of completion. So you can look for your home county on this spreadsheet and on this chart and you can find the year, which they complete reappraisal.

[Wayne Miller] And here's an interesting question. Do assessors use aerial photography in determining the condition of, or changes in, residential and commercial property in the real estate evaluation process?

[Billy Smothermon] Okay, so in the state of Arkansas we do utilize aerial photography. Primarily, its use in valuation is that of valuing agricultural land. Some counties do use it and

you have software to help them locate changes that have occurred in the property: new buildings, buildings torn down, that sort of thing.

For actual data gathering, in most counties in the state of Arkansas, it's still the case that the reappraisal contractors, or the appraisers who work for the county directly, either they visit the property if it's necessary conduct measurements, take photographs, speak with the property owner, and list the elements of the property directly in the field.

[Wayne Miller] Another question for you. How does Arkansas's method and valuing residential and commercial real estate property compare with methods used in other states?

[Billy Smothermon] Right, so Arkansas uses appraisal methods that are standard pretty much worldwide at this point. Earlier, Wayne, you mentioned that I'm a member of the International Association Assessing Officers, they are the organization that helps us establish standards of assessment and typical practices that we can then tweak to make useful for the state of Arkansas and pass on to our assessors.

The methods that we use in appraising real estate are common to most states. Of course, each state differs. There are different assessment levels, there are states that conduct annual reprisals where we conduct cyclical reprisals. So, there are some functional differences, but for the most part our methods are our standard across the board.

[Wayne Miller] One final question. How is the market factor determined on a residential or commercial property if there have been no homes or commercial buildings sold in the location, the past few years.

[Billy Smothermon] Great. So the market factor is determined primarily from sales that have occurred in the market. So in areas where there had been no sales, first on commercial property, it's a good application of the income approach, which we didn't discuss too much, but where there haven't been sales, income to income producing properties can be used to help them determine market value using the income less expenses to determine those values.

In neighborhoods where there haven't been sales, oftentimes within the county, there will be other neighborhoods that are comparable where there have been sales. Where you have sales of comparable properties in comparable neighborhoods, even if they aren't side by side, you can use measures of similarity to use sales that occurred in other areas, to help you determine values of those properties. Oftentimes, if there are no sales in the county over the reappraisal cycles sufficient to develop values, you'll see a situation where home [values] will remain static.