

# COMPONENTS OF A REAPPRAISAL PROGRAM

Mass appraisal for ad valorem tax purposes builds on the same principles as independent fee, single-property appraisal. Mass appraisal techniques, however, emphasize valuation modules (expressed as equations, tables and schedules), standards of practice and statistical quality control. A reassessment program consists of four basic subsystems:

1. A data management system.
2. A sales analysis system.
3. A valuation system.
4. An administrative system.

The subsystems are independent. For example, the valuation system uses information maintained in the sales analysis and data management systems and produces output (valuations) required by the administrative system in the production of tax bills.

## DATA MANAGEMENT SYSTEM

The data management system has components for collection, entry, editing, organization, conversion, storage and security of property characteristics and ownership data. This system is the heart of the Randolph County mass appraisal program. Quality control of this system is of the utmost importance because the accuracy of the values determined depends on the reliability of the data from which they are generated. In addition, data collection, conversion and maintenance are the most expensive aspect of any reappraisal program. Much thought and planning are required to detail the data management logic in order to minimize the operating costs of this system.

Data maintenance is the protocol for creating new parcels, capturing and valuing new construction and making changes to the county's current property database. The maintenance protocol consists of three components:

➤County land records system:

The daily creation of new parcels from the recording of "splits" (the sale of a part of an existing parcel). The recording of new subdivision plats feed the second component of our system.

➤Permits and inspections:

As the appraisal staff receives notice of new permits and inspections, property records are flagged and new data is collected daily. The real property appraisal section receives reports from building Inspections when new construction permits are issued and when the Certificate of Occupancy (hereinafter CO), is issued. Reports of the various inspections requested and required between the initial application and the CO, are received allowing staff to monitor the construction progress and make determinations of the percentage of construction completed as of 1 January each calendar year.

➤Periodic re-inspection of all properties:

Routine field visits are supplemented with information obtained from the latest Orthophotography, information provided by property owners as part of the annual

Listing abstracts, as well as requests from taxpayers for reviews or appeals and MLS Sold Reports.

## SALES ANALYSIS SYSTEM

The sales system has components for sales data collection, sales screening and processing, ratio studies and sales reporting. Assessment/sales ratio studies are the primary tool for measuring mass appraisal performance. They are invaluable for monitoring appraisal results, identifying reappraisal priorities, adjusting valuations to the market and assisting the administrative system in planning and scheduling.

Ratio studies and sales reports draw on values produced by the valuation system and on property characteristics maintained in the data management system.

The ongoing sales file program includes a computerized sales ratio study and report, an active computerized sales questionnaire system, an active sales maintenance routine and a collection of photographs on subject properties.

## VALUATION SYSTEM

The valuation system (CAMA) consists of mass appraisal applications of the three approaches to value and/or allows for various adjustments that recognize specific aspects of each approach.

- The **COST APPROACH** requires maintenance and application of computerized cost schedules and equations, depreciation schedules and indexing factors.
- **SALES COMPARISON APPROACH** applications include multiple regression analysis and model building for automated comparable sales analysis.
- The **INCOME APPROACH** will require income multipliers and overall rates.

The optimum results of the valuation system will be to consider all three approaches to value, as appropriate to property type and determine which method(s) produces the best results for the final appraisal. Properly executed, any of the three approaches to value will yield creditable results. The Sales Comparison and Income Approaches are highly dependent on available data. Only the Cost Approach can be uniformly applied with limited data.

The current economy has affected the number of arm's length sales occurring in the market. As is the case with any appraisal, a general county-wide reappraisal depends on data being available from a wide variety of sources in order to properly apply each of the three approaches to value. Even when an abundance of relevant data is available for applying the Sales Comparison Approach and the Income Approach that data may also be utilized in refining the Cost Approach. In the absence of relevant data prior to the final determination of reappraisal values, the Cost Approach becomes the more reliable approach for all property types as shown below:

Comparing the Three Approaches to Value to Various Property Types When Relevant Data is Available from the Market:

<u>RESIDENTIAL</u>	<u>COMMERCIAL</u>	<u>INDUSTRIAL / SPECIAL PURPOSE</u>
1. Sales Comparison	1. Income	<b>1. Cost</b>
<b>2. Cost</b>	<b>2. Cost</b>	2 or 3. Sales Comparison
3. Income	3. Sales Comparison	2 or 3. Income

## THE ADMINISTRATIVE SYSTEM

The administrative system is comprised of a variety of functions and activities; each of which requires information from the sales analysis, valuation, or data management systems and produces products used by the administrative system. For example, the appeals process uses valuation and property characteristics data and the results of sales ratios and reports. The results of the appeals process affect other systems in the form of data changes, value adjustments and recalculated ratio statistics. The administrative system serves throughout the reappraisal process; in the beginning in identifying areas of concern, throughout the reappraisal process as various analytical measures are studied and adjusted and at the conclusion when sales are measured against assessed values as part of a randomly-selected ratio study.

## IN-HOUSE REAPPRAISAL

An in-house reappraisal is a major effort requiring careful preparation, the support of county management and the Board of County Commissioners, adequate time and sufficient funds. The outlined plan will show the detailed work scheduling tasks and activities. The schedule takes into account the relationship between the daily operations of the tax office and the reappraisal program. It includes adequate time to cover probable delays and contingencies to deal with unforeseen problems.

The reappraisal process should be viewed as separate and distinct from daily operations. However, existing staff, duties, responsibilities and priorities must be modified and additional staff may be required. The tax office will have control over the quality and performance of additional personnel.

## SUMMARY

General reappraisals of real property are required by statutory authority to be performed on an octennial plan (the eight-year cycle). Counties may adopt a shorter cycle via a Resolution by their respective county board of commissioners. The prevailing trend in North Carolina is a four-year reappraisal cycle.

Reappraisal Cycle (# of Years between Reappraisals)	# of Counties
8-Year Reappraisal Cycle	55 Counties
6-Year Reappraisal Cycle	3 Counties
5-Year Reappraisal Cycle	1 County
4-Year Reappraisal Cycle	41 Counties

Presently, the trend is for counties to hire and train the staff in order to perform “In-House” reappraisals as opposed to “contracted” reappraisals with expertise being contracted from outside the county lines.

Type of Reappraisal	# of Counties
Contracted Reappraisals with an Outside Appraisal Firm	23 Counties
In-House Reappraisal with Full-time County Staff	33 Counties
Joint; Primarily In-House, but with some outside expertise	44 Counties

NOTE: Based on data supplied by the Property Tax Division of the NC DOR, the average parcel count for counties contracting with a reappraisal firm was 21,228 parcels. The average size of counties undertaking a Joint reappraisal effort was 49,060. Counties conducting In-House reappraisals averaged 68,814 parcels. The tax office understands that an effective reappraisal requires careful planning. A realistic analysis of the present state of the assessment records and values and the resources needed to conduct the reappraisal is always under consideration. Reappraisals are a costly, highly visible and politically sensitive undertaking. However, since the real property staff in the tax office understands its own resources and the technical requirements of the tasks, they are committed to conducting the most fair and equitable reappraisal. The success of this endeavor depends on the leadership of the tax office, an informed public awareness and committed management support.



Before an assessor can undertake his/her responsibilities and duties properly, he/she must be familiar with the legal framework in which his/her function is performed. In addition to the specific statutory direction and appellate court rulings, it is necessary to be well-versed with the nature of appraised values and property and with the basic economic principles that serve as the foundation of the valuation process.

### **Concepts of Property and Property Rights**

A discussion of property and property rights should begin with a definition of property. When the layman thinks of property, he tends to think of a thing. Legally, however, property is associated with the *right* of any person to possess, use, enjoy and dispose of a thing. Property, then, is a broad term expressing the relationship between owners and their rights in and to possessions. In appraising real property, the parcel to be appraised includes the rights inherent in the ownership of the property to be included in the opinion of value rendered by the reappraisal.

All property may be divided into two major categories—real property and personal property. Real property is defined as the sum of the tangible and intangible rights in land and improvements. It refers to the interest, benefits and rights inherent in the ownership of physical real estate. A synonym for real property is realty. Real estate, on the other hand, is the physical land and everything permanently attached to it. Personal property consists of movable items not permanently affixed to, or part of, the real estate and is commonly known as “personalty” or “chattels.”

Real estate may be divided into two categories—land and improvements. Land may be defined as the surface of the earth together with everything under its boundary and everything over it, extending indefinitely into the heavens. The shape of a parcel of land can be described as an inverted pyramid with its apex at the center of the earth and extending upward through the surface into space. Certain legal limitations have been imposed throughout the years by the Courts, such as the right of aircraft to fly over the land. Improvements (land improvements, such as paving, fencing, structures and landscaping) consist of immovable items affixed to and becoming part of the real estate. “Permanently affixed” refers to the original intent of the owner and the economic life of the improvements rather than “forever.”

In discussing the distinction between real estate and personal property, the term “affixed” was used. Defining “fixture” has been the subject of much litigation and the courts do not always agree. Generally speaking, personal property annexed to land is called a fixture. Chattels that have been annexed to land are called a fixture.

Chattels that have been annexed to the land so as to lose their character as chattels become real estate for ad valorem tax purposes. In determining the nature of the annexation of personal property, there are two basic considerations: first, the adaptability of the personal property to the use of that part of the realty and, second, the person by whom the annexation is made and his interest in the land and the personal property.

Courts tend to agree that, if the chattel is affixed to the land so that it loses its original physical character and cannot be restored to its original condition as a practical matter; it loses its nature as personal property and becomes real property. In some cases there are two basic tests to determine whether personal property becomes real property (1) the intention of the person who put the item in its place and whether the item may be removed from the real estate without damaging either the item or the real estate. An excellent example is in how NC law distinguishes manufactured homes as personal versus real property. N.C.G.S. 105-273(13)b. reads:

**“Real property, real estate, or land. – Any of the following:**

- a. The land itself.**
- b. Buildings, structures, improvements, or permanent fixtures on land.**
- c. All rights and privileges belonging or in any way appertaining to the property.**
- d. A manufactured home as defined in G.S. 143-143.9(6), unless it is considered tangible personal property for failure to meet all of the following requirements:**
  - 1. It is a residential structure.**
  - 2. It has the moving hitch, wheels and axels removed.**
  - 3. It is placed upon a permanent foundation either on land owned by the owner of the manufactured home or on land in which the owner of the manufactured home has a leasehold interest pursuant to a lease with a primary term of at least 20 years and the lease expressly provides for disposition of the manufactured home upon termination of the lease.”**

Another important distinction in property is that of tangible and intangible property. Tangible property consists of actual physical property. Intangible property is evidence of ownership of property rights. Examples of intangible property are patent rights, copyrights, notes, mortgages, deeds of trust and stock certificates.

## **Ownership of Property**

There are six basic rights associated with the ownership of property:

1. The right to use.
2. The right to sell.
3. The right to lease or rent.
4. The right to enter or leave (real property).
5. The right to give away.
6. The right to refuse to do any of these.

These rights are known as the “bundle of rights”, which is the ownership of all the legal rights obtained with fee-simple title. The bundle of rights may be compared to a bundle of sticks, each representing one property right. Property rights are divisible. Property ownership is sometimes transferred without the exchange of the full bundle of rights.

Unless property is owned by the government, it is subject to certain public and possibly private restrictions. The United States and other nations impose certain limitations for the common good. These public, or legal, restrictions thrust limitations on the full bundle of rights. Four rights, or "sticks," have been removed from the full bundle in favor of governmental control, identified as follow:

- Taxation - the right to tax the property for support of the government.
- Eminent domain - the right to take the property for public use provided that just compensation is paid.
- Police power - the right to regulate the use of property for the public welfare in the areas of safety, health, morals, zoning, building codes and traffic and sanitary regulations.
- Escheat - the right to have property revert to the state for nonpayment of taxes or where there are no legal heirs of a decedent who dies intestate.

Some examples of private limitations which affect fee-simple ownership of property are (1) the rights of other co-owners of the property; (2) covenants, conditions and restrictions that are found in the chain of title to the property; (3) mortgages (a mortgage is a written instrument pledging specified real estate as a guarantee for the repayment of a loan used to purchase property); (4) easements and rights of way (an easement is a right held by one person to use the land of another); (5) liens and judgments (a lien is a legal right to hold property or to have it sold or applied for a payment of a claim-n); and (6) leases.

## **Estates in Property**

An “estate” may be defined as the legal position or status of an owner with respect to the property and the degree or quantity of interest owned with respect to the nature of the right, its duration, or its relation to the rights of others. Estates in real property may be categorized according to the quality and duration of the property rights. The two main divisions in estates are freehold and non-freehold. A freehold estate is one which is to endure for an uncertain period of time but which usually lasts during the life of some person. Non-freehold estates endure for a specified period of time and may be subject to immediate termination. There are three basic types of freehold estates: fee simple absolute, fee tail and life estates.

An “estate in fee simple” is one which has been given to an individual and his heirs without any end or limit put to his estate. Fee-simple title is the greatest possible degree of ownership. It is title free and clear of all encumbrances, including easements, rights of way, liens and so forth. In other words, it is the ownership of

all legal rights. With certain statutory exceptions, fee-simple title is the only estate which the assessor values. Personal property is always valued by the assessor as free and clear of all encumbrances.

N.C.G.S. 105-302 sets forth the statutory direction regarding in whose name real property should be listed. In North Carolina, the property will be listed, appraised and assessed at "fee simple" to the holder of the life estate, usually referred to as the "life tenant". A life estate is granted with ownership limited to the life of the owner or that of another party.

G.S. 105-302 (c) (8) reads:

**"A life tenant or tenant for the life of another shall be considered the owner of real property and it shall be his duty to list the property for taxation, indicating on the abstract that he is a life tenant or tenant for the life of another named individual."**

Estates in real property may also be categorized according to the way in which title is held: tenancy in severalty indicates ownership interest by one owner; tenancy in common indicates ownership by more than one person where the interest is not divided and descends individually to each owner's heirs; tenancy by the entirety indicates joint ownership by husband and wife where ownership reverts to the survivor and cannot be disposed of individually during the lifetime of either. There are many different types of tenancy in which the assessor is interested primarily for the purpose of keeping ownership records up to date. Ultimately, North Carolina General Statutes control how ownership of all real property is determined for ad valorem tax purposes.

## **Nature of Property Appraisal or Value**

The word "value" is an abstract word; generic in nature, with many acceptable definitions and meanings, the term defying an exact definition to suit all circumstances. Generally speaking, its definition is largely dependent upon the context in which it is being used. In a broad sense, value can be defined as the relationship between an object desired and a potential purchaser. It is the ability of a commodity to command another commodity (money) in exchange. For purposes of real property appraisal, value may be described as the present worth of future benefits arising from the ownership of real property.

A major distinction must be made between value in use and value in exchange. A property may have relatively little value in use and a significantly different value in exchange. Value in use embodies the objective premise, which maintains that value is within the object itself. A hose rack built into a fire station is a useful and valuable item as long as the building is used as a fire station. If use as a fire station is abandoned, however, the hose rack probably will not add value to the property unless it can be used for an almost identical purpose. Under the concept of value in exchange, the subjective element is accentuated. In a subjective context, value is within the mind of man. The value-in-use concept easily accommodates cost. In an economic sense, value in exchange is the primary concern for the assessor because this value – market value – reflects the actions and reactions of buyers, sellers and investors.

In order for property to have value, there must be desirability, utility, scarcity and economic purchasing power. Utility is the capacity of goods to excite desire for possession and should not be confused with usefulness. Diamonds possess utility in that they excite a desire for possession in the minds of most people and usefulness in that they are the hardest substance known and have many industrial uses. Utility is a subjective concept, in the mind of man; usefulness is an objective concept, inherent in the property.

Scarcity is the third requirement for value. The air we breathe has utility, but it is not valuable, primarily because it is not scarce. There are two economic forces that determine scarcity: supply and demand. As

demand increases or supply decreases, the value of the goods will increase. Conversely, if the supply increases or the demand decreases, the value of the goods will decrease

Utility and scarcity by themselves do not confer value on an object, unless the desire by the purchaser is present, a desire backed by the economic purchasing power of the buyer(s).

A comparison of the terms "cost" and "price" is useful in a discussion of value. Cost may be defined as the sacrifice made in the acquisition of property and commonly reflects the perspective of the buyer. It may be incurred in either the purchase of an existing property or the construction of a new property. Price may be defined as the amount of money given or expected or arrived at arranging for the exchange of property. Cost and price may be the same. If a purchaser pays \$100,000 to buy a property, it may be stated that the property costs the purchaser \$100,000. However, while price is defined in terms of money, cost is expressed as a sacrifice. A sacrifice may be in terms of money, labor, or time. Also, when a property is sold, the price may be either above or below the owner's cost.

## Market Value

While the term "value" remains quite difficult to define, the term "market value" does not suffer from the same limitation. The constitutions and statutes of the 50 states have many different definitions of market value; they also have different definitions of value for property taxation, eminent domain, corporate reorganization and public utility rate regulation. The assessor must adhere to the definition of market value as stated in N.C.G.S. 105-283 and as interpreted in various decisions rendered by the North Carolina Appellate Courts, as set forth below:

N.C.G.S. 105-283. Uniform Appraisal Standard.

**“All property, real and personal, shall as far as practicable be appraised or valued at its true value in money. When used in this Subchapter, the words “true value” shall be interpreted as meaning market value, that is, the price estimated in terms of money at which the property would change hands between a willing and financially able buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all the uses to which the property is adapted and for which it is capable of being used. For the purposes of this section, the acquisition of an interest in land by an entity having the power of eminent domain with respect to the interest acquired shall not be considered competent evidence of the true value in money of comparable land.”**

NOTE: In analyzing sales of property, close attention is paid to identifying all transactions that are the result of a foreclosure or short sale. Such sales are not retained for further consideration in determining the schedules set out elsewhere in this document and neither will they be considered in analyzing the reappraisal results via the State-mandated assessment/sales ratio study.

Several Appellate Court cases have addressed the issue of defining market value:

- **Neither this section nor G.S. 105-317(a) requires the commission to value property according to its sales price in a recent arm’s length transaction when competent evidence of a different value is presented.**

In re *Greensboro Office Partnership*, 72 N.C.App. 635, 325 S.E.2d 24, cert. denied, 313 N.C. 602, 330 S.E.2d 610 (1985).

- **The purpose of the statutory requirement that all property be appraised at its true value in money is to assure, as far as practicable, a distribution of the burden of taxation in proportion to the true values of the respective taxpayers' property holdings, whether they be rural or urban.**  
In re *King*, 281 N.C. 533, 189 S.E.2d 158 (1972).
- **In substance this section and G.S. 105-317.1 provide that all property shall be appraised at market value and that all the various factors which enter into the market value of property are to be considered by the assessors in determining this market value for tax purposes.**  
In re *Bosley*, 29 N.C.App. 468, 224 S.E.2d 686, cert. denied, 290 N.C. 551, 226 S.E.2d 509 (1976).
- **Where sale was not between a willing buyer and a willing seller, as contemplated by this section, sales price was not indicative of property's true value.**  
In re *Phoenix Ltd. Partnership*, 134 N.C. App. 474, 517 S.E.2d 903 (1999)
- **Section 105-317(a), in fixing the guide which assessors must use in valuing property for taxes, includes as a factor the past income therefrom and its probable future income. But the income referred to is not necessarily actual income. The language is sufficient to include the income which could be obtained by the proper and efficient use of the property. To hold otherwise would be to penalize the competent and diligent and to reward the incompetent or indolent.**  
In re *Greensboro Office Partnership*, 72 N.C.App. 635, 325 S.E.2d 24, cert. denied, 313 N.C. 602, 330 S.E.2d 610 (1985).
- **To find the true value of property subject to conservation easements, the Commission must determine the market value prior to the granting of the easements and then reduce that value by applying a damage factor caused by the granting of the conservation easements. Determining the highest and best use of the property prior to the granting of the easement is a critical part of the appraisal process.**  
In re *Rainbow Springs Partnership v. County of Macon*, 79 N.C. App. 335, 339 S.E.2d 681, cert. denied, 316 N.C. 736, 345 S.E.2d 392 (1986).
- **A post-octennial valuation sale is not a statutory permissive basis for adjusting a property's tax valuation.**  
In re *Allred*, 351 N.C. 1, 519 S.E.2d 52 (1999)
- **State Tax Commission's reliance upon an independent appraiser's collateral determination of petitioners' property value, without challenge or correlation to the county's schedules of value or the application of those schedules to the property, was in violation of the statutory requirement of this section that any permissible increase or decrease in the appraised value of real property be calculated using the schedules and standards established by the county.**  
In re *Allred*, 351 N.C. 1, 519 S.E.2d 52 (1999)
- **In order for a taxpayer to have valuation set aside, he must show more than a failure to follow statutory procedures. It is not enough for the taxpayer to show that the means adopted by the tax supervisor were wrong; he must also show that the result arrived at is substantially greater than the true value in money of the property assessed, i.e., that the valuation was unreasonably high.**  
In re *Highlands Dev. Corp.*, 80 N.C. App. 544, 342 S.E.2d 588 (1986).

Other General Legal References that bear on the Concept of Value :

- **The North Carolina General Assembly and no one else, determines how property in this State should be valued for purposes of ad valorem taxation.**  
In re *Amp, Inc.*, 287 N.C. 547, 215 S.E.2d 752 (1975).
- **The legislature has decreed that all property, real and personal, within the jurisdiction of the State, is subject to taxation whether owned by a resident or a nonresident. The purpose of this strong decree is to treat all property owners equally so that the tax burden will be shared proportionately and to gather in all the tax money to which the various counties and municipalities are entitled.**  
In re *Plushbottom & Peabody, Ltd.*, 51 N.C. App. 285, 276 S.E.2d 505, cert. denied, 303 N.C. 314, 281 S.E.2d 653 (1981).
- **Uniformity in taxation relates to equality in the burden of the State's taxpayers.**  
In re *Martin*, 286 N.C. 66, 209 S.E.2d 766 (1974).
- **Ad valorem tax assessments are presumed to be correct and when such assessments are challenged, the burden of proof is on the taxpayer to show that the assessment was erroneous.**  
In re *Bosley*, 29 N.C.App. 468, 224 S.E.2d 686, cert. denied, 290 N.C. 551, 226 S.E.2d 509 (1976).
- **Ad valorem tax assessments are presumed correct. In order to rebut this presumption, the taxpayer must present evidence to show that an arbitrary method of valuation was used, or that an illegal method of valuation was used and that the assessment substantially exceeded the true value in money of the property.**  
In re *Interstate Income Fund I*, 126 N.C. App. 162, 484 S.E.2d 450 (1997).
- **In order to obtain relief from valuations upon their property by the State Board of Assessment, appellant electric membership corporations must show that the methods used in determining true value were illegal and arbitrary, and that appellants were substantially injured by a resulting excessive valuation of their property.**  
In re *Albemarle Elec. Membership Corp. v. Alexander*, 282 N.C. 402, 192 S.E.2d 811 (1972).
- **Burden is on the taxpayer to show that it comes within the exemption or exception.**  
In re *Martin*, 286 N.C. 66, 209 S.E.2d 766 (1974).
- **Exemption from taxation is exceptional. Such exemptions should be strictly construed.**  
In re *Notice of Attachment & Garnishment Issued by Catawba County Tax Collector*, 59 N.C. App. 332, 296 S.E.2d 499 (1982), cert. denied, 307 N.C. 576, 299 S.E.2d 645 (1983).

The following important points regarding market value should be noted:

- It is the most probable price.
- It is not the highest, lowest, or average price.
- It is expressed in terms of money.
- It implies a reasonable time for exposure to the market.
- It implies that both buyer and seller are well-informed of the uses to which the property may be put. It requires an arm's length transaction in the open market.
- It requires a willing buyer and willing seller, with no advantage being taken by either buyer or seller. This is a constraint against consideration of foreclosures and short sales.
- It recognizes the present use as well as the potential use of the property.

## Highest and Best Use

The way in which property is used, or could be used, plays an essential role in determining its market value. Most appraisal organizations recognize the highest and best use of a given property must conform to the following four points:

- It must be a legal use. (in many instances zoning will identify the legal use)
- It must be a physically possible use.
- It must be an economically feasible use.
- It must be the use that generates the greatest net return to the owner.

Almost all property is subject to competing uses. Rural land is subject to the competition of farming and grazing. Urban land is subject to many competing uses; a single parcel of land may be sought after as the site for a store, gas station, apartment building, or office building. When determining an opinion of market value, it is necessary to determine which of the competing uses is the highest and best use.

Highest and best use may be defined as that use which will generate the highest net return to the property over a period of time. Further amplification of this definition is necessary for a clear understanding of the term.

The highest and best use must be a legal use. This means not only that the use cannot be criminal but also that it must be permitted under local administrative regulations, such as zoning. Assuming that zoning regulations are strictly enforced, the highest and best use may be limited. If it is easy to obtain a change or variance in zoning, uses not permitted by current regulations must be considered along with the probability that zoning will be changed. The use also must not be prohibited by enforceable restrictions contained in the chain of title to the property.

The use must be a probable use and not a highly unlikely or speculative one. There must be a demand for the use either in the present or in the near future. This, of course, is determined by persons in the market and not by a bias on the part of the assessor. It is important to consider as well that the highest and best *use may* be the present use or an entirely different one. It may even be a combination of uses over a period of time. Imagine, for example, a site in a good downtown location on which stands a three-story store with a 75 percent vacancy factor. Assume that the site could be developed with a modern fifteen-story office building. However, since there is currently too much unrented office space on the market, the highest and best use of the property might be as a parking lot for the next five years. Once the excess office space is absorbed, its highest and best use could be as an office building.

The highest and best use will be a complementary rather than a competitive use. For example, if there are gas stations on three of four corners, a fourth gas station will reduce the customers that are available to all four stations. However, suppose that on the fourth corner a fast-food restaurant were established. The restaurant would draw business from the gas station customers. Conversely, the gas stations would draw *business from* the restaurant's customers.

The highest and best use must be the most profitable for the entire property, land, buildings and other improvements—since the market deals with the total property unit and land and buildings usually are not sold separately. Also, when estimating highest and best use, the assessor should not combine parcels of common ownership that are used independently for different purposes.

The highest and best use generates the highest net return over a reasonable period of time. A use that yields a very high immediate income but one of short duration may not be as valuable as a use that results in a lower but more prolonged income stream. Just as everything changes with time, the highest and best use of property will change. The character of a neighborhood may be altered, thereby creating demands for

different uses. The assessor periodically reviews conclusions as to highest and best use and revises them according to the data that are collected.

Properties in transition present a difficult appraisal problem. Not only must a new highest and best use be found for the property, but also an estimate must be made as to when the property will begin the new use. Occasionally, there will be an interim use prior to the future highest and best use. In order to estimate the value of these consecutive uses, the benefits must be identified, valued and summed. The total value is the sum of:

1. The present worth of the income stream from the interim use for the period of that use less the cost of erecting interim improvements.
2. The present worth of the salvage value of the interim improvements less the present worth of removing them.
3. The present worth of the income stream from the future use less the present worth of erecting the future improvements.

For example, assume that a vacant parcel of land downtown has a highest and best use as a parking lot for five years and as a twenty-five-story office building thereafter. The sum of the future benefits is shown as pluses and minuses in the following example:

Plus . . . .

1. Present worth of parking-lot income for five years,
2. Present worth of salvage value of parking-lot improvements deferred five years,
3. Present worth of sixty-year income stream from twenty-five-story office building deferred six years  
(one year for construction)

Minus . . . .

1. Cost of erecting parking-lot improvements: paving, fencing and small office.
2. Present worth of cost to demolish parking-lot improvements deferred five years.
3. Present worth of cost to construct a 25-story office building deferred six years.

## **Basic Principles of Value**

These principles, which have evolved from economic doctrine, are generally accepted as having a direct effect on the modern concept of value. It should be emphasized that these principles rarely if ever can be considered in isolation; it is typical to conceive of them in an interrelated setting, for they tend to complement and accompany one another. It should also be pointed out that highest and best use is the resulting use after considering the interrelationship among the basic appraisal principles.

The following are generally regarded as essential to the understanding of the appraisal function. They are listed (in alphabetical order) as follows:

### ***Principle of Anticipation:***

Market value is the present worth of all the anticipated future benefits to be derived from the property. The benefits may be in the form of an income stream or amenities. Anticipated future benefits are those benefits anticipated by the market. The assessor should not allow personal opinion to influence the determination of anticipated future benefits. Past sales of the property and past income are of importance only when they are an indication of what may be expected in the future. The principle of anticipation works in conjunction with the principle of change.

### ***Principle of Balance:***

The principle of balance has dual significance. When applied to an individual property, the principle states that maximum market value is reached when the four agents of production - labor, coordination or management, capital and land attain a state of equilibrium. In the case of individual properties, the principle works in conjunction with the principles of contribution, increasing and decreasing returns and surplus productivity. When applied to a neighborhood, the principle of balance indicates that maximum market value is reached when the complementary uses of land attain equilibrium. For example, a single-family residential neighborhood requires commercial facilities such as grocery stores, gasoline stations, drugstores and so forth. It also needs residential support facilities such as churches, schools, recreational facilities and the like. When these complementary uses are in balance, the individual properties (and the neighborhood) achieve maximum market value. When the principle of balance is applied to a neighborhood, it works in conjunction with the principle of competition.

### ***Principle of Change:***

This principle states that market value is never constant, because economic, social and governmental forces are at work to change the property and its environment. In addition, property itself is constantly changing. For example, the forces of nature can change the quality of the soil and improvements change by aging. Because change is continuous, the estimate of market value is valid only on the effective day for which it is made. The principle of change works in conjunction with the principle of anticipation.

***Principle of Competition:***

The principle states that when substantial profits are being made, competition is created. This leads to the aphorism that profit tends to breed competition and that excess profit breeds ruinous competition. A neighborhood can support only a certain number of bowling lanes, department stores, gasoline service stations and shopping centers. An excess of any one type of facility will tend to decrease the value of most, if not all, other such facilities.

***Principle of Conformity:***

This principle states that maximum market value is reached when a reasonable degree of economic and social homogeneity is expected in the foreseeable future. When the principle is applied to improvements, reasonable homogeneity implies reasonable similarity, not monotonous uniformity. When it is applied to the residents, it means similarity in age, income, background, education, attitudes and so on. Conformity works in conjunction with the principles of progression and regression and is essential in understanding the “neighborhood” concept as a mass appraisal technique.

***Principle of Consistent Use:***

This principle states that the property must be valued with a single use for the entire property. It is improper to value a property on the basis on one use for the land and another use for the improvements. This is not to say that consecutive uses for the entire property would violate the principle of consistent use. The principle of consistent use is especially applicable to a property in transition from one use to another.

While the improvements on a parcel ready for a higher use may theoretically have a long physical life, their economic life may have already terminated. In this case the improvements may have a negative value, namely, the cost of demolition.

***Principle of Contribution:***

This principle states that the value of an agent of production (or a property component) depends upon its contribution to the whole. This is another way of saying that cost does not necessarily equal value. Some examples are:

1. Cost does not always equal value. Ten thousand dollars is spent on labor, (which is a cost), to build a two-car garage. What has the \$10,000 worth of labor contributed to the value of the property-- less than \$10,000, \$10,000 or more than \$10,000?
2. The real estate market tends to look at the contribution of a property characteristic in broad terms. While there can be significant cost differences between a stucco chimney and a very plain fireplace profile versus a stone chimney and fireplace profile, that difference in cost may very likely not be likewise reflected in the value of the two homes located in the same neighborhood with the very different chimneys and fireplaces.
3. An owner spends \$20,500 to erect a garage for use with the home. Based on a comparable sales analysis, it is determined that such a garage adds \$21,500 to the overall market value of the property. In this case \$21,500 is the value contribution of the garage.
4. In the case of income-producing properties, the value of an agent in production (or property component) can be measured by the amount it contributes to net income, since net income can be capitalized into value. For example, assume that the owner of a small retail store finds that, by spending \$2,000 for an air-conditioning unit, annual gross income from rents can be increased by \$650. Additional operating expense due to the air-conditioning unit will be only \$400, including

amortization of the investment. Consequently, installation of this unit will add value to this property in excess of its cost. If the additional annual income were less than \$400, the expense would not be practical.

This principle is the basis for the adjustment process of the comparative sales approach to value and the direct sales comparison method of land valuation, for determining whether physical deterioration and functional obsolescence are curable or incurable and for justifying remodeling and modernization. Many of the adjustments to value that are detailed herein for various property characteristics, are based on their contribution to the whole property, not their actual cost.

The principle of contribution works in conjunction with the principles of balance, increasing and decreasing returns and surplus productivity.

### ***Principle of Increasing and Decreasing Returns:***

This principle states that when successive increments of one agent of production are added to fixed amounts of other agents, future net benefits (income or amenities) will increase up to a certain point (point of decreasing returns), after which successive increments will decrease future net benefits. For example, assume a number of hypothetical buildings, each constructed on the same site.

- A 10,000 square foot building that can earn 1.4 percent on its cost;
- A 20,000 square foot building that can earn 5.5 percent on its cost;
- A 30,000 square foot building that can earn 8.0 percent on its cost;
- A 40,000 square foot building that can earn 5.8 percent on its cost;
- A 50,000 square foot building that can earn 1.2 percent on its cost.

In this illustration, constructing larger buildings will produce increasing returns up to the point of a 30,000 square foot building. Beyond this point, additional investment to construct a larger building starts to contribute to diminishing returns. The principle of increasing and decreasing returns works in conjunction with the principles of balance, contribution and surplus productivity.

### ***Principles of Progression and Regression:***

Progression indicates that the value of a lesser object is enhanced by association with better objects of the same type. For example, a \$72,000 house among \$125,000 homes could probably bring a higher price in the market. The principle of regression states that when there are dissimilar properties within the same general classification and in the same area, the better property will be adversely affected. Thus, when a \$150,000 house is located in an area where the typical home is in the \$75,000 category, the market value of the former will tend to fall. The \$150,000 house, in this example, is an over-improvement for the neighborhood. The principles of progression and regression work in conjunction with the principle of conformity. This principle is sometimes referred to as the “hydraulic principle” – all waters tend to seek the same level – whereas comparable properties within a given neighborhood tend to seek a common market level.

### ***Principle of Substitution:***

A property's market value tends to be set by the cost of acquiring an equally desirable and valuable substitute property, assuming that no costly delay is encountered in making the substitution. This principle serves as the basis of the three approaches to value-cost, comparative sales and income.

### ***Principle of Supply and Demand:***

This principle states that market value is determined by the interaction of the forces of supply and demand. A sudden increase in the population of an area would increase demand. If, at the same time, mortgage interest rates rose sharply, demand might lessen.

### ***Principle of Surplus Productivity:***

This principle states that the net income remaining after the cost of the agents of production-labor, coordination and capital has been paid is considered surplus productivity. The surplus productivity is the income earned by or attributable to the land. The agents in production must be satisfied in the following order: labor (wages), coordination (management), capital (improvements) and land. As a result, land value tends to be set by the cost of labor, coordination and capital. The principle of surplus productivity works in conjunction with the principles of balance, contribution and increasing and decreasing returns.

### **Important Concepts Regarding Property**

1. Real property is the sum of tangible and intangible rights in land and improvements. Real estate is the physical land and everything permanently attached to it. Personal property consists of movable items not permanently affixed to, or part of, the real estate.
2. Land is the surface of the earth together with everything under its boundary and everything over it. Improvements are movable items affixed to and becoming part of the real estate.
3. The six basic rights associated with the ownership of property are the rights to use, sell, lease, or rent, enter or leave, give away and refuse to do any of these.
4. The four limitations imposed by governments on the private ownership of property are taxation, eminent domain, police power and escheat.
5. Fee-simple title is the greatest possible degree of ownership and is title free and clear of all encumbrances.

### **Concepts of Value**

1. Value in use embodies the objective premise, which maintains that value is within the object itself. Value in exchange holds that value is within the mind of man. Value in exchange-market value- is the primary goal of the assessor.
2. Desire, utility, scarcity and economic purchasing power are essential in creating value.
3. Market value is the most probable price, expressed in terms of money, that a property would bring if exposed for sale in the open market in an arm's-length transaction between a willing seller and a willing buyer, both of whom are knowledgeable concerning all the uses to which it is adapted and for which it is capable of being used.
4. Estimating market value is dependent upon determining the highest and best use of the property. Highest and best use is defined as the legal, physically possible and economically feasible use which will generate the highest net return to the property over a period of time.
5. The determination of highest and best use requires the proper application of the interrelated appraisal principles.

## TRADITIONAL APPROACHES TO VALUE

Value is an elusive item that occurs in many different forms. The forces and influences which combine to create, sustain, or destroy value are numerous and varied. It is the appraiser's function to define the type of value sought (market value in North Carolina for ad valorem tax purposes), to compile and to analyze all related data and giving due consideration to all the factors which may influence the value, to process and translate that data into a final opinion or *estimate of value*. This, appraisers must do for each parcel to be appraised.

The processing of this data into a conclusion of value generally takes the form of three recognized approaches to value; Cost Approach, Sales Comparison Approach and Income Approach. The use of one or all three approaches in the valuation of a property is determined by the quantity, quality and accuracy of the data available to the appraiser for that particular property type. Underlying each of the approaches is the Principle of Substitution; that the justifiable price of a property is no more than the cost of acquiring and/or reproducing an equally desirable substitute property.

The COST APPROACH involves making an estimate of the depreciated cost of reproducing or replacing the building and site improvements. *Reproduction Cost* refers to the cost at a given point in time of reproducing an exact replica of the improvements, whereas *Replacement Cost* refers to the cost of producing improvements of equal utility, but using modern materials and construction techniques. Depreciation is deducted from this cost new for loss in value caused by physical deterioration and functional or economic obsolescence. To this depreciated cost is then added the estimated value of the land, resulting in an indication of value derived by the Cost Approach.

The significance of the Cost Approach lies in its extent of application . . . it is the one approach that can be used on all types of construction. It is a starting point for appraisers and therefore it is a very effective "yardstick" in any equalization program for ad valorem taxes. Its widest application is in the appraisal of properties where the lack of adequate market and income data preclude the reasonable application of the other traditional approaches.<sup>1</sup>

The SALES COMPARISON APPROACH involves compiling sales and offerings of properties, which are comparable to the property being appraised. These sales and offerings are then adjusted for any dissimilarities and a value range obtained by a comparison of said properties. The approach is reliable to the extent that the properties are comparable and the appraiser's judgment of proper adjustments is sound. The procedure for using this approach is essentially the same for all types of property with the only difference being the elements of comparison.

The significance of this approach lies in its ability to produce estimates of value, which directly reflect the attitude of the market. Its application is contingent upon the availability of comparable sales and therefore finds its widest range in the appraisal of vacant land and residential properties. Applicable North Carolina case law includes:

**Neither this section nor G.S. 105-317(a) requires the commission to value property according to its sales price in a recent arm's length transaction when competent evidence of a different value is presented.**

In re *Greensboro Office Partnership*, 72 N.C.App. 635, 325 S.E.2d 24, cert. denied, 313 N.C. 602, 330 S.E.2d 610 (1985).

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<sup>1</sup> Please refer to the chart at the top of Page 6 comparing the relative strengths of the three approaches to value to Residential, Commercial and Industrial/Special Purpose property.

**Where sale was not between a willing buyer and a willing seller, as contemplated by this section, sales price was not indicative of property's true value.**

In re *Phoenix Ltd. Partnership*, 134 N.C. App. 474, 517 S.E.2d 903 (1999)

Essentially, North Carolina law prohibits the presumption that the sale price of any particular property must be the basis for its appraised value for ad valorem tax purposes. Instead, reliance is placed on the greater weight of evidence determined from a larger sampling of comparable properties and as a result, the appraised value may be less than or greater than the sale price of any particular property.

The INCOME APPROACH measures the present worth of the future benefits of a property by the capitalization of the net income stream over the remaining economic life of the property. The approach involves making an estimate of the "Effective Gross Income" (EGI), of a property, derived by deducing the appropriate "Vacant and Collection Loss" from its estimated "Gross Potential Income" (GPI), based on its economic rent, as evidenced by the yield of comparable properties. From this figure are deducted applicable operating expenses, the cost of taxes and insurance and reserve allowances for replacements resulting in an estimate of "Net Income", which may then be capitalized into an indication of value.

The income approach obviously has its basic application in the appraisals of properties universally bought and sold on their ability to generate and maintain a stream of income for their owners. The effectiveness of the approach lies in the appraiser's ability to relate to the changing economic environment and to analyze income yields in terms of their relative quality and durability. Applicable North Carolina case law includes:

**Section 105-317(a), in fixing the guide which assessors must use in valuing property for taxes, includes as a factor the past income therefrom and its probable future income. But the income referred to is not necessarily actual income. The language is sufficient to include the income which could be obtained by the proper and efficient use of the property. To hold otherwise would be to penalize the competent and diligent and to reward the incompetent or indolent.**

In re *Greensboro Office Partnership*, 72 N.C.App. 635, 325 S.E.2d 24, cert. denied, 313 N.C. 602, 330 S.E.2d 610 (1985).

**Neither this section nor G.S. 105-317(a) requires the commission to value property according to its sales price in a recent arm's length transaction when competent evidence of a different value is presented.**

In re *Greensboro Office Partnership*, 72 N.C.App. 635, 325 S.E.2d 24, cert. denied, 313 N.C. 602, 330 S.E.2d 610 (1985).

**If it appears that the income actually received is less than the fair earning capacity of the property, the earning capacity should be substituted as a factor rather than the actual earnings. The fact finding board can properly consider both.**

In re *Property of Pine Raleigh Corp.*, 258 N.C. 398, 128 S.E.2d 855 (1963);

In re *Valuation of Property Located at 411-417 W. Fourth St.*, 282 N.C. 71, 191 S.E.2d 692 (1972).

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## ***THE COST APPROACH***

If the highest and best use *of* a property is its current use, a valid indication of value may be derived by estimating the value of the land and adding the land value to the depreciated value of the structures on the land; the resulting equation being...

$$\begin{array}{r} \text{Estimated Land Value} \\ + \text{ Estimated Replacement Cost New of Structures} \\ - \text{ Estimated Depreciation} \\ = \text{ Indication of Property Value} \end{array}$$

Since estimating the land value is covered in a separate section, this section will address itself to the two remaining elements, Replacement Cost and Depreciation.

### **REPLACEMENT COST**

Replacement Cost is the current cost of producing an improvement of equal utility to the subject property; it may or may not be the cost of reproducing a replica property. The distinction being drawn is one between Replacement *Costs*, which refers to a substitute property of equal utility, as opposed to *Reproduction Cost*, which refers to an exact replica of the property. In a particular situation the two concepts may be interchangeable, but they are not necessarily so. They both, however, have application in the Cost Approach to value, the difference being reconciled in the consideration of depreciation allowances.

In actual practice, outside of a few historic type communities in this country, developers and builders, for obvious economic reasons, replace buildings, not reproduce them. It logically follows that if an appraiser's job is to measure the actions of knowledgeable persons in the market place, the use of proper replacement costs should provide an accurate point of beginning in the valuation of most improvements.

The replacement cost includes the total cost of construction incurred by the builder whether preliminary to, during the course of, or after completion of the construction of a particular building. Among these are material, labor, all subcontracts, builders' overhead and profit, architectural and engineering fees, consultation fees, survey and permit fees, legal fees, taxes, insurance and the cost of interim financing.

### **ESTIMATING REPLACEMENT COST**

There are various methods that may be employed to estimate replacement cost new. The methods widely used in the appraisal field are the quantity survey method, the unit-in-place or component part-in-place method and the model method.

*The Quantity-Survey Method* involves a detailed itemized estimate of the quantities of various materials used, labor and equipment requirements, architect and engineering fees, contractor's overhead and profit and other related costs. This method is primarily employed by contractors and cost estimators for bidding and budgetary purposes and is much too laborious and costly to be effective in every day appraisal work, especially in the mass appraisal field. The method, however, does have its place in that it is used to develop certain unit-in-place costs, which can be more readily applied to estimating for appraisal purposes.

The *Unit-in-Place Method* is employed by establishing in-place cost estimates (including material, labor, overhead and profit) for various structural components. The prices established for the specified components

are related to their most common units of measurement such as cost per yard of excavation, cost per lineal foot of footings and cost per square foot of floor covering.

The unit prices can then be multiplied by the respective quantities of each component as they are found in the composition of the subject building to derive the whole dollar component cost, the sum of which is equal to the estimated cost of the entire building, providing of course, that due consideration is given to all other indirect costs which may be applicable. This component part-in-place method of using basic units can also be extended to establish prices for larger components in-place such as complete structural floors (including the finish flooring, sub-floor, joists and framing), which are likely to occur repeatedly in a number of buildings.

The *Model Method* is still a further extension, in that unit-in-place costs are used to develop base unit square foot or cubic foot costs for total specified representative structures in place, which may then serve as "models" to derive the base unit cost of comparable structures to be appraised. The base unit cost of the model most representative of the subject building type is applied to the subject building and appropriate tables of additions and deductions are used to adjust the base cost of the subject building to account for any significant variations between it and the model.

Developed and applied properly, these pricing techniques will assist the appraiser in arriving at valid and accurate estimates of replacement cost new as of a given time, which for ad valorem tax purposes is always January 1 of the reappraisal year. That cost generally represents the upper limit of value of a structure. The difference between its replacement cost new and its actual value is depreciation. The final step in completing the Cost Approach then is to estimate the amount of depreciation and deduct said amount from the replacement cost new.

## **DEPRECIATION**

Simply stated, "accrued depreciation" is defined as "a loss in value from all causes". As applied to real estate, it represents the loss in value between market value and the sum of the replacement cost new of the improvements plus the land value as of a given time. The causes for the loss in value may be divided into three broad classifications; Physical Deterioration, Functional Obsolescence and Economic Obsolescence.

*Physical Deterioration* pertains to the wearing out of the various building components, referring to both short-life and long-life terms, through the action of the elements, age and use. The condition may be considered either "curable" or "incurable", depending upon whether it may or may not be practical and economically feasible to cure the deficiency by repair and replacement.

*Functional Obsolescence* is a condition caused by either inadequacies or super-adequacies in design, style, composition, or arrangement inherent to the structure itself, which tends to lessen its usefulness and desirability in the marketplace. Like physical deterioration, the condition may be considered either curable or incurable. Some of the more common examples of functional obsolescence are inadequate wall and ceiling heights, excessive structural construction, surplus capacity and ineffective layouts.

*Economic Obsolescence* is a condition caused by factors extraneous to the property itself, such as encroachment of inharmonious land uses on adjoining or nearby parcels. The condition is generally incurable in that the causes lie outside the property owner's realm of control.

## **ESTIMATING DEPRECIATION**

An estimate of depreciation represents an opinion of the appraiser as to the degree that the present and future appeal of a property has been diminished by deterioration and obsolescence. Of the three estimates necessary to the cost approach, it is the one most difficult to make. The accuracy of the estimate will be a product of the appraiser's experience in recognizing the symptoms of deterioration and obsolescence and the ability to exercise sound judgment in equating all observations to the proper monetary allowance to be deducted from the replacement cost new. There are several acceptable methods, which may be employed:

Physical deterioration and/or functional obsolescence can be measured by observing and comparing the physical condition and/or functional deficiencies of the subject property as of a given time with either an actual or hypothetical, comparable, new and properly planned structure.

Curable physical deterioration and functional obsolescence can be measured by estimating the cost of restoring each item of depreciation to a physical condition as good as new, or estimating the cost of eliminating the functional deficiency.

Functional and economic obsolescence can be measured by capitalizing the estimated loss in rental due to the structural deficiency or lack of market demand.

Total accrued depreciation may be estimated by first estimating the total useful life of a structure and then translating its present condition, desirability and usefulness into an effective age (rather than an actual age), which would represent that portion of its total life (percentage), which has been used up.

Total accrued depreciation may also be estimated by deriving the amount of depreciation recognized by purchasers as evidenced in the prices paid for property in the market place; the loss of value being the difference between the cost of replacing the structure new and its actual selling price (total property selling price less the estimated value of the land).

## **INTRODUCTION**

The justified price paid for income producing property is no more than the amount of investment required to produce a comparably desirable return; and since the market can be analyzed in order to determine the net return actually anticipated by investors, it follows that the value of income producing property can be derived from the income which it is capable of producing. What is involved is an estimate of income through the collection and analysis of available economic data, the development of a proper capitalization rate and the processing of the net income into an indication of value by employing one or more of the acceptable capitalization methods and techniques.

The caveat to a sole reliance on the above premise in the income approach occurs when actual and/or economic rents will not support the sales price. In those instances, other forces must be assumed to be present; the anticipation of future benefits being foremost.

## **THE PRINCIPLES OF CAPITALIZATION**

*Capitalization* is the process for converting the net income produced by property into an indication of value. Through the years of appraisal history, a number of procedures have been recognized and employed by appraisal authorities in determining the value of real estate by the income approach. For ad valorem tax purposes, when and where reliable data is available, direct capitalization will be used.

## **EXPLORING THE RENTAL MARKET**

The starting point for the appraiser is an investigation of current economic rent in a specific area in order to establish a sound basis for estimating the gross income, which should be returned from competitive properties. The appraiser must make a distinction between *economic rent* and the rent which the property would normally be expected to produce on the open market, as opposed to *actual rent* or that which the property is actually producing at the time of the appraisal, usually due to lease terms established sometime in the past.

The first step then is to obtain specific income and expense data on properties, which best typify normal market activity. The data is necessary to develop local guidelines for establishing the economic rent and related expenses for various types of properties.

The next step is to similarly collect income and expense data on individual properties and to evaluate the data against the established guidelines. The collection of income and expense data (I & E) is an essential phase in the valuation of commercial properties. The appraiser is primarily concerned with the potential earning power of the property. The objective is to estimate its expected net income. Income and Expense Statements of past years are valuable only to the extent to which they serve this end. The statements must not only be complete and accurate, but must also stand the test of market validity. Consideration of the following factors should assist the appraiser in evaluating the "Income & Expense" data in order to arrive at an accurate and realistic estimate of net income; sometimes expressed as "Net Income Before Recapture".

Randolph County sends surveys soliciting income and expense data from property owners of commercial (income-producing) property. Historically, these surveys are not well-received by the public. Historically, a more significant amount of additional information becomes available upon the mailing of the reappraisal

notices of value. At that point, as part of the local appeals process, income and expense data is generally provided by the property owner in support of their claim seeking a decrease in appraised value. The quality/worth of that data is dependent on the documentation provided. Lease information (lease rates, terms and other stated considerations) is best. Undocumented statements are least useful.

**NOTE:** Randolph County, as part of our development of the 2014 Schedules of Values, Standards and Rules, recently mailed surveys to Mobile Home Park Owners and owners of commercial property, with the following results, to date:

- 3160 surveys mailed
- 1259 surveys returned (39.84%)

Randolph County recently subscribed to Karnes © in order to have access to their database of commercial property listings and sales. This statewide database allows for us to narrow our search to listings and sales located within Randolph County only. Given the number of commercial enterprises in our county, this database is an attempt to obtain as much information as possible.

#### **QUESTIONS RELATING TO INCOME DATA**

- A. Was the reported income produced entirely by the subject property? Very often the rental will include an amount attributable to one or more additional parcels of real estate. In this case, it would be necessary to obtain the proper allocations of rent.
- B. Was the income attributable to the subject property as it physically existed at the time of the appraisal, or did the appraisal include the value of leasehold improvements and remodeling for which the tenant paid in addition to rent? If so, it may be necessary to adjust the income to reflect economic rent.
- C. Does the reported income represent a full year's return? It is often advisable to obtain both monthly and annual amounts as a crosscheck.
- D. Does the income reflect current economic rent? Is either part or all of the income predicated on old leases? If so, what are the provisions for renewal options and rates?
- E. Does the reported income reflect 100% occupancy? What percentage of occupancy does it reflect? Is this percentage typical of this type of property, or is it due to special non-recurring causes?
- F. Does the income include rental for all marketable space? Does it include an allowance for space, if any, which is either owner or manager occupied? Is the allowance realistic?
- G. Is the income attributable directly to the real estate and conventional amenities? Is some of the income derived from furnishings and appliances? If so, it will be necessary to adjust the income or make provisions for reserves to eventually replace them, whichever local custom dictates.
- H. In many properties an actual rental does not exist because the real estate is owner occupied. In this event it is necessary to obtain other information to provide a basis to estimate economic rent. The information required pertains to the business operation using the property. Proper analysis of the annual operating statements of the business, including gross sales or receipts, can provide an accurate estimate of economic rent. Caution must be exercised to relate the income and expense data as it is attributable to the property and not the business enterprise. Information requirements for a few of the more common property uses are as follows:

Retail Stores	The annual net gross sales (Gross sales less returned merchandise) and leased space if any.
Hotels and Motels	The annual operating statement of the business. If retail or office space is leased in these properties, obtain the actual rent paid.
Theaters	The annual gross receipts (including admissions and concessions) and seating capacity.
Automobile Parking	The annual gross receipts.

## ANALYSIS OF EXPENSE DATA

The appraiser must consider only those expenses, which are applicable to the cost of ownership; that is, those expenses, which are normally owner incurred. Any portion of the expenses incurred directly or indirectly by the tenant should not be considered. Each expense item must stand the test of both legitimacy and accuracy. How do they compare with the established guidelines and norms? Are they consistent with the expenses incurred by comparable properties?

Management refers to the cost of administration. These charges should realistically reflect what a real estate management company would actually charge to manage the property. If no management fee is shown on the statement, the appraiser must make a proper allowance. On the other hand, if excessive management charges are reported, as is often the case, the appraiser must disregard the reported charges and use an amount, which he deems appropriate and consistent with comparable type properties. The cost of management bears a relationship with the risk of ownership and will generally range between 4 to 10% of the gross income.

*General expenses* may include such items as the cost of services and supplies not charged to a particular category. Unemployment and F.I.C.A. taxes, Workmen's Compensation and other employee insurance plans are usually legitimate deductions when employees are a part of the building operation.

*Reimbursed expenses* refer to the cost associated with the maintenance of public or common areas of the commercial property. This expense is passed on to the tenants and should, therefore, only be considered when the amount of reimbursement is included as income.

*Miscellaneous expenses* are the "catch-all" category for incidentals. This item should reflect a very nominal percentage of the income. If expenses reported seem to be excessive, the appraiser must examine the figures carefully in order to determine if they are legitimate and if so, to allocate them to their proper category.

*Cleaning expenses* are legitimate charges. Many are for such items as general housekeeping and maid service and include the total cost of labor and related supplies. All or a portion of the cleaning services may be provided by outside firms working on a "contract" basis. Cleaning expenses vary considerably and are particularly significant in operations such as offices and hotels. "Rule of thumb" norms for various operations are made available through national management associations. The appraiser should have little difficulty in establishing local guidelines.

*Utilities* are generally legitimate expenses and if reported accurately, need very little reconstruction by the appraiser, other than to determine if the charges are consistent with comparable properties. Local utility companies can provide the appraiser with definite guidelines.

*Heat and Air Conditioning* costs are often reported separately and in addition to utilities. The expenses would include the cost of fuel other than the above-mentioned utilities and may include, especially in large installations, the cost of related supplies, inspection fees and maintenance charges. These are generally legitimate costs and the same precautions prescribed for "utilities" are in order.

*Elevator* expenses, including the cost of repairs and services, are legitimate deductions and are generally handled through service contracts. These fees can generally be regarded as fairly stable annual recurring expenses.

*Decorating and minor alterations* are necessary to maintain the income stream of many commercial properties. In this respect they are legitimate expenses. However, careful scrutiny of these figures is required. Owners tend to include the cost of major alterations and remodeling which us, in fact, capital expenditures and as such are not legitimate operating expenses.

*Repairs and Maintenance* expenses reported for any given year may not necessarily be a true indication of the average or typical annual expense for these items. For example, a statement could reflect a substantial expenditure for a specific year (possibly because the roof was replaced and/or several items of deferred maintenance were corrected); yet the statement for the following year may indicate that repairs and maintenance charges were practically none. It is necessary for the appraiser to either obtain complete economic history on each property in order to make a proper judgment as to the average annual expense for these items, or include a proper allowance based on norms for the type and age of the improvements to cover annual expenses. Since it is neither possible nor practical to obtain enough economic history on every property, the latter method is generally used and the amounts reported for repairs and maintenance are then estimated by the appraiser.

*Insurance.* Caution must be used in accepting insurance expense figures. Cost shown may be for more than one year, or may be for blanket policies including more than one building. It is generally more effective for the appraiser to establish his own guidelines for insurance. He must also be careful to include only items applicable to the real estate. Fire extended coverage and owner's liability are the main insurance expense items. Separate coverage's on special component parts of the buildings, such as elevators and plate glass, are also legitimate expenses.

*Real Estate Taxes.* In making appraisals for tax purposes, the appraiser must exclude the actual amount reported for real estate taxes. Since future taxes will be based on his appraised value, the appraiser must express the taxes as a factor of the estimated value. This can be done by including an additional percentage in the capitalization rate to account for real estate taxes.

*Depreciation.* The figure shown for depreciation on an operating statement is a "bookkeeping figure" which the owner uses for Internal Revenue purposes and should not be considered in the income approach. This reflects a tax advantage, which is one of the benefits of ownership.

*Interest.* Although interest is considered a legitimate expense, it is always included in the Capitalization Rate. Most property is appraised as if it were "free and clear"; however, the appraiser does consider the interest of a current mortgage in the Capitalization Rate build-up.

*Land Rent.* When appraising for real estate tax purposes, only the sum of the leasehold and the leased fee is usually considered. Land rent is not deducted as an expense. Considered separately, rent from a ground lease would be an expense to the leasehold interest and an income to the leased fee. However, if land were rented from another property to supply additional parking for example, that land rent would be an allowable expense.

It is obvious that there are some expense items encountered on operating statements that the appraiser should not consider as allowable. This is because he is interested in legitimate cash expenses only. Income statements are usually designed for income tax purposes where credit can be taken for borrowing costs and theoretical depreciation losses.

It is virtually impossible and certainly not always practical to obtain a complete economic history on every commercial property being appraised. On many properties, however, detailed economic information can be obtained through the use of Income and Expense forms. One must realistically recognize the fact that the data obtainable on some properties is definitely limited.

In most cases, the gross income and a list of the services and amenities furnished can be obtained during the data gathering operation. However, in order to insure a sound appraisal, it may be necessary to estimate the fixed *and operating expenses*. This is best accomplished by setting guidelines for expenses, based on a percent of Effective Gross Income or a cost per square foot of leasable area. These percentages or costs will vary depending on the services supplied and the type of property.

## CAPITALIZATION METHODS

The most prominent methods of capitalization are Direct, Straight Line, Sinking Fund and Annuity. Each of these is a valid method for capitalizing income into an indication of value. The basis for their validity lies in the action of the market, which indicates that the value of income producing property can be derived by equating the net income with the net return anticipated by informed investors. This can be expressed in terms of a simple equation:

$$\text{Value} = \text{Net Income} \div \text{Capitalization Rate}$$

The *Straight Line and Sinking Fund* methods are both actual forms of Straight Capitalization, with one using Straight Line recapture and the other using Sinking Fund recapture. Both methods follow the same basic principles as Direct Capitalization, differing only in that they provide for separate Capitalization rates for land and buildings; the building rate differing from the land rate in that it includes an allowance for recapture.

*Straight Line Capitalization* allows for "recapture" based on remaining economic life of the building - implying that at the end of that period of time, there would be a zero improvement value. There are three fallacies in this thinking. First, the potential buyer (investor) has no intention of holding the property that long. The average investment period might average ten years. Second, the investor anticipates that at the end of that period he will either get all his money back or will make a profit. And third, is the depreciation allowance possible in connection with federal income taxes.

Depreciation allowances begin to "run out" between seven and ten years, so the advantages of owning the property are reduced considerably. A prudent owner may choose to sell the property at this point and re-invest in another property so that he may begin the depreciation cycle again and continue to take full advantage of the favorable tax laws.

For these reasons, the Straight Line Capitalization Method does not usually follow what the market indicates.

*Straight Line recapture* calls for the return of investment capital in equal increments or percentage allowances spread over the estimated remaining economic life of the building.

*Sinking Fund recapture* calls for the return of invested capital in one lump sum at the termination of the estimated remaining economic life of the building. This is accomplished by providing for the annual return

of a sufficient amount needed to invest and annually re-invest in "safe" interest-bearing accounts, such as government bonds or certificates of deposit, which will ultimately yield the entire capital investment during the course of the building's economic life.

*Annuity Capitalization* lends itself to the valuation of long-term leases. In this method, the appraiser determines, by the use of annuity tables, the present value of the right to receive a certain specified income over stipulated duration of the lease. In addition to the value of the income stream, the appraiser must also consider the value that the property will have once it reverts back to the owner at the termination of the lease. This reversion is valued by discounting its anticipated value against its present day worth. The total property value then is the sum of the capitalized income stream plus the present worth of the reversion value.

## **CURRENT TECHNIQUES**

There are two methods, however, that do lend themselves to an accurate measure of market value based on potential income. These are Direct Capitalization, utilizing the Direct Comparison Method of Rate Selection and Mortgage Equity Capitalization.

### **DIRECT CAPITALIZATION**

In *Direct Capitalization*, the appraiser determines a single "overall" capitalization rate. This is done by analyzing actual market sales of similar types of properties. He develops the net income of each property and divides the net income by the sales price to arrive at an overall rate to provide an indication of value. Many of the appellate court rulings regarding the valuation of income-producing properties for ad valorem tax purposes have relied on direct capitalization.

### **MORTGAGE EQUITY CAPITALIZATION**

*Mortgage Equity Capitalization* is a form of direct capitalization with the major difference in the two approaches being the development of the overall capitalization rate.

In this method, equity yields and mortgage terms are considered influencing factors in construction of the interest rate. In addition, a plus or minus adjustment is required to compensate for anticipated depreciation or appreciation. This adjustment can be related to the recapture provisions used in other capitalization methods and techniques.

## **RESIDUAL TECHNIQUES**

It can readily be seen that any one of the factors of the Capitalization Equation ( $\text{Value} = \text{Net Income} \div \text{Capitalization Rate}$ ) can be determined if the other two factors are known. Furthermore, since the value of property is the sum of the land value plus the budding value, it holds that either of these can be determined if the other is known. The uses of these mathematical formulas in capitalizing income into an indication of value are referred to as the *residual techniques*, or more specifically, the property residual, the budding residual and the land residual techniques.

*The Property Residual Technique* is an application of Direct Capitalization. In this technique, the total net income is divided by an overall capitalization rate (which provides for the return on the total investment) to arrive at an indicated value for the property. This technique has received more popular support in recent

years because it closely reflects the market. With this technique, the capitalization rate may be developed by either "direct comparison" in the market or by the Mortgage Equity Method.

The *Building Residual Technique* requires the value of the land to be a known factor. The amount of net income required to earn an appropriate rate of return on the land investment is deducted from the total net income. The remainder of the net income (residual) is divided by the building capitalization rate (which is composed of a percentage for the return on the investment, plus a percentage for the recapture of the investment) to arrive at an indicated value for the building.

The *Land Residual Technique* requires the value of the building to be a known factor. The amount of net income required to provide both a proper return on and the recapture of the investment is deducted from the total net income. The remainder of the net income (residual) is then divided by the land capitalization rate (which is composed of a percentage for the return on the investment) to arrive at an indicated value for the land.

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## **SALES COMPARISON OR MARKET APPROACH**

### **GENERAL DISCUSSION:**

The SALES COMPARISON APPROACH to value is a method for estimating the market value of a property on the basis of information from sold properties. It is the most commonly used approach in the minds of many participating in the market, as it mimics their general inclinations whether buying and selling a car, a piece of furniture, or an item of clothing. In the process of making comparisons, the buyer generally is aware of a comparable car, piece of furniture, or a similar piece of clothing available at a different business for a different or not-so-different price. Sellers are also mindful of what is being offered in the market that is in direct competition with what they are attempting to sell.

The SALES COMPARISON is so named because the act of comparison is the basic technique being employed. Actually, comparisons are made in each of the three valuation approaches. It is more accurate to say the entire appraisal process is a series of comparisons. This is especially true in the mass appraisal process for property tax administration, where in the final analysis it must be demonstrated that all taxable properties have been uniformly, accurately and equitably valued.

### **INTRODUCTION TO THE SALES COMPARISON APPROACH:**

Constitutions, statutes and case law define a market value standard for assessment purposes. When sales data is available, the sales comparison approach is generally considered the most reliable. However, in North Carolina assessment litigation, under the "**rules of evidence**" a bona fide sale of the subject property may not be considered the best evidence of market value "**when competent evidence of a different value is presented**". In re *Greensboro Office Partnership*, 72 N.C.App. 635, 325 S.E.2d 24, cert. denied, 313 N.C. 602, 330 S.E.2d 610 (1985).

The purpose, in both the North Carolina statutory language and the interpretation of relating actual sales to market value by the North Carolina Courts, is to emphasize uniformity and the equitable distribution of the tax burden relative to the premise that similar properties should share similarly in that burden. For that reason, no property is likely to be appraised and assessed for its most recent sales price. Instead, each sale will be included in the sales file from which sales will be analyzed by property type, location, etc. and from which assessments can be fine-tuned for greater uniformity.

The SALES COMPARISON APPROACH models the behavior of the market by comparing the properties being appraised (subject property) with similar properties that have recently sold (comparable properties), or for which offers to purchase have been made. Comparable properties are selected for their similarity to the subject property. Their sales prices are then adjusted for their differences from the subject. Finally, a market value for the subject is determined from the adjusted sales prices of the comparable properties.

The economic principles of supply and demand provide a framework for understanding how the market works. The interaction of supply and demand factors impacts property prices. Supply depends on current inventories and, in the longer run, on the availability of human skills, material and capital. Demand is influenced by population levels, mortgage rates, income levels, local services, personal housing preferences and the cost of substitutes. One demand factor is the cost of substitutes, which ensures that prudent consumers will pay no more for a piece of property than for comparable properties with equal utility,

assuming no unreasonable delays. The Principle of Substitution implies that the market will recognize differences in utility between the subject and its best alternatives by a difference in price.

The SALES COMPARISON APPROACH requires the following steps:

- Definition of the appraisal problem.
- Data collection.
- Analysis of market data to develop units of comparison and select attributes for adjustment (model specification).
- Development of reasonable adjustments (model calibration).
- Application of the model to adjust the sales prices of comparables to the subject property.
- Analysis of the adjusted sales prices to indicate the value of the subject property.

The entire valuation process depends on accurately defining the appraisal problem, because the nature of the problem determines the sources of information, methods of comparable selection and adjustment techniques.

Defining the appraisal problem includes:

- Identifying the property (Parcel Number or PIN for ad valorem tax purposes)
- The rights to be appraised (generally Fee Simple for ad valorem tax purposes)
- The date of appraisal (January 1 of the reappraisal year)
- The use (Highest and Best Use)
- The type of value to estimate (Market Value, for NC ad valorem tax purposes)

The rights to be valued can be a partial interest or fee simple absolute interest. Fee simple absolute interest is usually assumed for both the subject and comparable sales. The date of the appraisal, the "as of" date, is usually defined by statute. In narrative appraisals, the date of appraisal is identified on the valuation report. All comparables are adjusted to the "as of" date.

The collection of accurate data is also essential to the SALES COMPARISON APPROACH. The appraiser analyzes market data to identify important supply and demand factors and determine data needs.

Although the SALES COMPARISON APPROACH has such a wide application as a method of estimating value there are factors, which do or can limit its usefulness. Examples of these limitations include the following:

1. No provision is made for arriving at an estimate of value in those cases where no comparable properties have been sold in recent months or years.
2. No two properties are ever exactly alike. At the very least, they vary in location, even if they are alike in other respects.
3. Depreciation affects value. Because houses are dissimilar in quality of construction and materials, they depreciate at varying rates. Even structures built exactly alike depreciate at different rates because of inevitable differences in maintenance, occupancy and use.
4. Amenities, being intangible qualities, are difficult to compare. The value of otherwise similar houses may not be the same because of the direction in which one house faces or the view it affords its occupants.

5. Learning the exact conditions attending each sale is essential so that the validity of the sale as comparative data may be substantiated. If the owner had to sell and could not wait for an "informed buyer" and/or was unaware of the current market, the price he accepted may not be indicative of the property's value in the market. Many motivations lead to the transfer of real property at figures unrelated to its market value. Transfers of property between relatives frequently do not give a true indication of market value and are rarely relied upon as being "arm's length".
6. Properties can vary considerably in their appointments and equipment; heating system, plumbing and electrical equipment and fixtures, insulation, kitchen facilities and built-in features. All of these factors must be considered in the comparative process, adjusting for the degree of variation. The more factors to be compared and adjusted, the greater the number of decisions and judgments the appraiser must make. Obviously, the more decisions and judgments that must be made, the greater the incident of error.

In spite of its limitations, the SALES COMPARISON APPROACH has broad application in all appraisal work. The value estimates found by the use of this approach are considered particularly significant because they are expressions of value as established by transactions in the market place.

Randolph County employs the SALES COMPARISON APPROACH to estimating Market Value for both the residential category and some commercial properties. Additionally, some valuation parameters of the other valuation approaches (cost & income) are influenced by the application of and observations gleaned from the SALES COMPARISON APPROACH.

#### **EXPLANATION OF THE SALES COMPARISON APPROACH PROCESS:**

There are five specific applications of the SALES COMPARISON APPROACH in the appraisal process. Three relate to residential properties and two relate to commercial properties.

##### Residential

- Multiple Regression Analysis via Group Modeling (MRA)
- Comparable Sales Estimate of Value (Comp Sales)
- Time Adjustment of Previous Selling Price (TASP)

##### Commercial

- Capitalization of Net Income (*Income*)
- Comparable Value Approach

The quality of these five applications, moreover, the quality of the appraisal/assessment base for real property, depends upon the quality of the sales file.

Conceptually, the database is made up of two separate, interacting, storage files:

- I. A large file (Property Characteristics File) that houses the property characteristics on all properties and
2. A smaller sub-file (Sales Information File) created from the Property Characteristics File that houses a "snapshot" of the information stored in the characteristics file, plus, additional information such as sales date, sale amount, etc.

The purpose of the "Sales File", in addition to facilitating faster processing time, is to permit adjustments to a "Sales File" parcel so that the condition of the property as of the time of sale can be reflected without alteration to the current property characteristics stored in the "property Characteristics File".

In determining market value by the SALES COMPARISON APPROACH a sufficient number of complete and valid sales are imperative. Therefore, proper procedures should be developed and adhered to in the

creation and maintenance of a "Sales File". Otherwise, the results produced from an "unverified" Sales File would be unreliable and most likely, misleading.

**MAJOR STEPS IN THE SALES REVIEW PROCESS**

There are four major efforts required to insure that the information contained in the Sales File is as accurate as possible.

Step 1. Identification – A review of all available ownership transfer information (deeds, records, MLS, etc.) should take place to "identify", for further analysis, those properties that may be included in the Sales File.

Step 2. Screening - An office review (screening) of the sold properties being considered for inclusion in the Sales File should be conducted to code transactions that are obviously invalid, such as transactions between family or related parties.

Step 3. Verification - After office screening, the property characteristics and sales information on sold property should be verified (and/or corrected) so that they reflect the "status" of the property at the time of sale. Following are different methods of sales verification.

1. Telephone confirmation
2. Mailing and return of sales verification letters
3. On-site, field visit
4. Multiple Listing Service

**NOTE:** Randolph County mails a *Sales Confirmation Questionnaire* to all buyers. Upon receipt of a recorded deed that meets all the apparent requirements of an *arm's-length* sale, the questionnaire is mailed; a good percentage of which are filled out, completed and mailed back to us (we include a return envelope, we do not include the return postage). See below:

Year	# Mailed	# Returned	Percentage Returned
2007 Jan – Dec	4,775	2,602	54%
2008 Jan – Dec	2,344	1,352	58%
2009 Jan – Dec	2,202	1,259	57%
2010 Jan – Dec	1,671	973	58%
2011 Jan – Dec	882	510	58%
2012 Jan – Mar	245	111	45%

(Years 2007-2010-questionnaires mailed to buyer & sellers)

Randolph County subscribes to the Asheboro/Randolph Realtors and Triad Multiple Listing Service (hereinafter, MLS) and attempts to confirm all sales through their MLS Sold Reports. If confirmed through MLS, the Sales Specialist copies the sold reports for parcels and stores in notebooks. Randolph County considers sales confirmation through MLS as the 2<sup>nd</sup> most reliable source, following the returned *Sales Confirmation Questionnaire* from the buyer.

Occasionally, staff is made aware of confirmed sales included as a part of an appraisal reports authored by an independent fee appraiser. Such information is considered the 3<sup>rd</sup> most reliable source. When verified by a member of our staff, the confirmation can be elevated to the most reliable source, equal to a returned *Sales Confirmation Questionnaire* from a buyer.

Randolph County considers Deed Stamps attached to a recorded General Warranty Deed to be the 4<sup>th</sup> most reliable source, only slightly more reliable than an un-confirmed source.

Once the parcel conveyance has been confirmed or “Qualified as a reliable indication of an “arm’s-length transaction, the Tax Market/ Sales Specialist reviews the tax data against the MLS Sold document to verify record. If anything from our various sources appears to be in conflict with the tax data, an onsite visit is conducted.

Step 4.Validation - Because the Sales File is not limited to just "good" sales it is necessary to assign a "validity code" to each property. This code allows for the sorting and grouping of various properties for analysis and reporting purposes. Invalid sales are coded based on NCDOR edit sheet for disqualifying sales.

### **TASP - TIME ADJUSTED SALE PRICE**

The TIME ADJUSTED SALE PRICE (TASP) is basically an extrapolation to the present day (January 1 of the reappraisal year), of a previously known selling price as of a specific date for a particular property, based upon the market trend in the area of the property in question. It should be noted in particular that two parameters must be known about the particular property before this extrapolation is made, namely the exact date and amount of transfer consideration. Moreover, it is also necessary to have an established set of accurate sales data on similar properties in the area, in order to establish the trend of sales prices over a period of time. The important feature of this calculation is that it does not establish a total estimated selling price from an "a priori" calculation; rather it merely calculates the increment of value that has been added to an already established market value. That is to say, the Time Adjusted Selling Price does not attempt to establish the magnitude of the market value, but rather it computes a value increment based on the change in market value in an area. Thus, the market value for a particular property is established by the market itself at some point in the past, while the change in that known market value to today's date is indicated by the trend in market values in that area.

The calculation of the TIME ADJUSTED SELLING PRICE (TASP) depends upon the knowledge of the selling price at some known time in the past and the ability to compute the increment of value added (or subtracted) since that time. The standard equation for TASP is as follows:

$$\text{TASP} = \text{PREVIOUS SELLING PRICE} + \text{INCREMENTAL Value}$$

Where INCREMENTAL VALUE equals NUMBER OF MONTHS INTERVAL X TASP adjustment factor X the previous sale amount.

### **RESIDENTIAL PROPERTIES CATEGORY**

For residential properties, the three market approaches to estimating Market Value are similar in that they each depend upon measured relationships between property data and sales data. They are different, however, in their specific focus and accordingly, one market approach may be more appropriate than another, depending upon the information and situation. For example, TASP is an excellent market approach technique when the subject property has recently sold. Also, MRA via the analysis of sales of properties similar to the individual property being appraised (IMRA) may produce better results than MRA against a mixed group of sold properties (MRA).

### **CALIBRATING THE SALES COMPARISON MODEL**

- **DETERMINING ADJUSTMENT AMOUNTS**

During model specification, the appraiser determines the significant attributes and the relationships among the attributes. The adjustment amounts (coefficients) are determined during model calibration. Paired sales analysis, multiple regression analysis, adaptive estimation procedure and the cost method are often used to calibrate sales comparison models.

- **PAIRED SALES**

Paired sales analysis is the foundation of single-property appraisal by the sales comparison approach. Paired sales analysis requires that sales properties be identical in all attributes except the attribute being measured or that adjustments have already been made for the other attributes. The assessor compares these sales and isolates the value contribution for the desired attribute.

Calibrating with paired sales analysis is usually impractical in mass appraisal because it is difficult to find sales that meet the above narrow conditions. Even more unreasonable is the expectation that sales are available to measure all the attributes needed in the sales comparison approach. In addition, it is difficult, if not impossible, to determine rates of change using this method, such as when the contribution for additional square feet decreases as the size of the property increases. However, paired sales analysis can be useful when many homogeneous sales are available; for example, in some residential neighborhoods (condominiums are one example), it can be used to determine both time and attribute adjustments.

An analysis of re-sales using paired sales analysis is one method of determining time adjustments. It is necessary to use properties that have had no changes between the sale dates. The steps are:

1. List the sales
2. Calculate the percent change between the first sale price and the resale price
3. Divide the percent change by the number of months
4. Estimate a time adjustment from the results.

As with any data, the level of confidence in the estimate is a function of the regency, amount, variance and reliability of the data. Proper functional fit to a well-specified model is also essential to good estimates.

When an adequate volume of sales is available, the appraiser can use paired sales to estimate qualitative and quantitative adjustments. Again, the analysis requires that attributes other than the one being measured remain constant. This process differs from estimating the time adjustment because re-sales are not required (sales should occur at the same time or have already been adjusted for time). In paired sales analysis, the appraiser must determine benchmark properties for measurement purposes. The paired sales method can be used for any adjustment including size, style, garage, basement, or location. The greater the number of sales, the greater the level of confidence in the adjustments.

In preceding sections, the fundamental concepts, principles and valuation techniques underlying the appraisal process has been outlined. The task is to reappraise all real property within Randolph County via a systematic mass appraisal program, with the goals of producing appraisal results that yield valid, accurate and equitable property valuations at a reasonable cost, as dictated by budgetary limitations and within a time span compatible with administrative needs.

The key elements of the program are validity, accuracy, equity, economy and efficiency. To be effective, the program must...

- incorporate the application of proven and professionally acceptable techniques and procedures;
- provide for the compilation of complete and accurate data and the processing of that data into an indication of value approximating the prices actually being paid in the market place as of the effective assessment date;
- provide the necessary standardization measures and quality controls essential to promoting and maintaining uniformity throughout the jurisdiction;
- provide the appropriate production controls necessary to execute each phase of the operation in accordance with a carefully planned budget and work schedule; and
- provide techniques especially designed to streamline each phase of the operation, eliminating superfluous functions and reducing the complexities inherent in the appraisal process to more simplified but equally effective procedures.

In summary, the objective of an individual fee appraisal is to arrive at an opinion of value, the key elements being the validity of the approach and the accuracy of the estimate. The objective of a mass appraisal for tax purposes is essentially the same. However, in addition to being valid and accurate, the value of each property must be equitable to that of each other property and what's more, these valid, accurate and equitable valuations must be generated as economically and efficiently as possible.

## **OVERVIEW**

The prime objective of mass appraisals for tax purposes is to equalize property values. Not only must the value of one residential property be equalized with another, but it must also be equalized with each agricultural, commercial and industrial property within the County.

The common denominator and the basis for equalization is market value, set forth by N.C.G.S. 105-283 as the Uniform Appraisal Standard, as follows:

**“All property, real and personal, shall as far as practicable be appraised or valued at its true value in money. When used in this Subchapter, the words “true value” shall be interpreted as meaning market value, that is, the price estimated in terms of money at which the property would change hands between a willing and financially able buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all the uses to which the property is adapted and for which it is capable of being used. For the purposes of this section, the acquisition of an interest in land by an entity having the power of eminent domain with respect to the interest acquired shall not be considered competent evidence of the true value in money of comparable land.**

The job of the appraiser is to arrive at a reasonable estimate of that justified price. To accomplish this, the coordination of approaches to the valuation of the various classes of property must be made relative to one another in such a way as to reflect the motives of the prospective buyers and sellers of each type of property.

A prospective buyer of a residential property is primarily interested in its capacity to render service to the family as a place to live. Its location, size, quality, design, age, condition, desirability and usefulness are the primary factors to be considered in making a selection. By relying heavily upon powers of observation, knowing what could be afforded and simply comparing what is available, one property will eventually stand out to be more appealing than another. So it is likewise the job of the ad valorem appraiser to evaluate the relative degree of appeal of one property to another.

The prospective buyer of agricultural property will be motivated somewhat differently. The primary interest will be in the productive capabilities of the land. It is reasonable to assume that the buyer will be familiar, at least in a general way, with the productive capacity of the farm. It might be expected that the prudent investor will have compared one farm's capabilities against another. Accordingly, where the highest and best use of the property is for agricultural purposes, the appraiser must rely heavily upon prices being paid for comparable farmland in the community.

The prospective buyer of commercial property is primarily interested in the potential net return and possible tax shelter the property will provide. Ideally, the property must return the investment made by the purchase price and provide a return on that investment. Real estate, as an investment, not only must compete with other real estate, but also with stocks, bonds, annuities and other similar investment areas. The commercial appraiser must explore the rental market and compare the income-producing capabilities of one property to another.

The prospective buyer of industrial property is primarily interested in the overall utility value of the property. Of course, in evaluating the overall utility, individual consideration must be given to the land and each improvement thereon. Industrial buildings are generally of special purpose design and often, cannot readily be divorced from the operation for which they were built. As long as the operation remains effective, the building will hold its value. However, if the operation becomes obsolete, the building likewise will become obsolete. The upper limit of its value is its replacement cost new and its current value is some measure of its current usefulness relative to the purpose for which it was originally designed.

Any effective approach to value for ad valorem tax purposes must be patterned in such a way as to reflect the typical motivation of buyers in the market place. As indicated above, the motives influencing prospective buyers tend to differ depending upon the type of property involved. It follows that the appraiser's approach to value must differ accordingly.

The residential appraiser must rely heavily upon the market data approach to value . . . analyzing the selling prices of comparable properties and considering the very same factors of location, size, quality, design, age, condition, desirability and usefulness which were considered by the buyer.

The rural appraiser must likewise rely primarily upon the market data approach to value, but in addition to analyzing the selling prices of comparable properties, an effective analysis of the farm's productive potential might also be necessary.

Rural dwellings are similar to urban dwellings in that their primary purpose is to provide a family with a home. As such, the appraiser should value them in the same manner as the valuation of any other residence. The approach to farm buildings, however, must be somewhat different. Here, the primary objective is to

arrive at that value which the building's presence contributes to the highest and best use of the property, either as a farm or so other competing use, taking into consideration their degree of utility or usefulness. In determining the productive capabilities of the land in the Land Use program, it will be necessary to divide the land into various classes according to specific types and uses, such as tillable, pasture, woodland and wasteland; to compute the acreage of each class; and to value each class individually. Due consideration must be given to soil types and their fertility, making every effort to utilize all soil and land maps available through agriculture extension services and state universities. Similarly, should the highest and best use be a competing use, equal consideration must be given to all other factors affecting the value of the property, such as its location relative to the market place, its relative accessibility, the topography of the land, the shape and size of the parcel, etc..

The commercial appraiser will find that since commercial property is not bought and sold as frequently as is residential property, the sales market will likely not be readily established. By relying heavily on the income approach to value, the net economic rent which the property is capable of yielding can be determined and the amount of investment required to affect that net return at a rate commensurate with that normally expected by investors, can also be determined. This can only be achieved through a comprehensive study of the income-producing capabilities of comparable properties and an analysis of present-day investment practices.

The industrial appraiser will not be able to rely on the market data approach because of the absence of comparable sales, each sale generally reflecting different circumstances and conditions. Also, it is not possible to rely upon the income approach. Again, most industrial property is owner-occupied and it is difficult to accurately determine the contribution of each building unit to the overall income produced. There is also an absence of comparable investments. Therefore, ad valorem appraisals typically rely heavily on the cost approach, requiring careful estimates in the loss of value resulting from physical, functional and economic factors.

The fact that there are different approaches to value, some of which are more applicable to one class of property than to another, does not, by any means, preclude equalization between classes. Remember that the objective in each approach is to arrive at a price which a well-informed buyer, fully aware of the existence of competing properties and not being compelled to act, is justified in paying for any one particular property. Underlying and fundamental to each of the approaches is the comparison process. Regardless of whether the principal criteria are actual selling prices, income-producing capabilities, or functional usefulness, like properties must be treated alike.

The primary objective is equalization; the equitable distribution of the tax burden. The various approaches to value, although valid in themselves, must nevertheless be coordinated one to the other in such a way as to produce values which are not only valid and accurate, but are also equitable. The same "yardstick" of values must be applied to all properties and must be applied by systematic and uniform procedures.

It is obvious that sales on all properties are not required to effectively apply the market data approach. The same is true regarding any other approach. What is needed is a comprehensive record of all the significant physical and economic characteristics of each property in order to compare the properties of "unknown" values with the properties of "known" values. All significant differences between properties must in some measure, either positively or negatively, be reflected in the final estimate of value.

Each property must be given individual treatment, but the treatment must be uniform and standardized and essentially no different than that given to any other property. All the factors affecting value must be analyzed and evaluated for each and every property within the County. It is only by doing this that equalization between properties and between classes of properties can be ultimately realized.

All this, at best, is an oversimplification of the equalization process underlying the entire Mass Appraisal Program. The program itself consists of various operational phases and its success depends primarily upon the systematic coordination of collecting and recording data, analyzing the data and processing the data to an indication of value.

## **DATA INVENTORY**

Basic to the appraisal process is the collecting and recording of pertinent data. The data will consist of general supporting data – that data required to develop the elements essential to the valuation process; neighborhood data - information regarding pre-delineated neighborhood units; and specific property data – property characteristics compiled for each parcel of property. All the resulting information will be processed into an indication of value by the cost, market and/or income approach.

The data must be comprehensive enough to allow for the adequate consideration of all factors which significantly affect property values. In keeping with the economics of a mass appraisal program, it is costly and impractical to collect, maintain and process data of no or marginal contribution to the desired objectives. Appraisers, if given the choice, would generally opt for "too much data". What is more important is to have an appropriate amount of data, no more or no less than necessary to support and generate the necessary and defensible valuations.

- *General Supporting Data.* The appraisal staff will be primarily concerned with cost, sales and income data, but they will also find it necessary to research and compile general socioeconomic information pertaining to the entire political unit under appraisal. The information will serve to assist the staff during the analytical phase of the operation and should include, but not necessarily be limited to, population trends, prevailing geographical factors, primary transportation facilities, primary income sources, unemployment and income levels, institutional influences, the annual volume of new construction and ownership transfers, availability of vacant land, construction labor and material costs, preponderance of residential rentals and the amount of residential vacancies.
- *Cost data* must be sufficient enough to develop or select and validate the pricing schedules and cost tables required to compute the replacement cost new of improvements needed to apply the cost approach to value.
- All data pertaining to the cost of total buildings in place should include the parcel identification number, property address and date of completion, construction cost, name of builder, source of information, structural characteristics and other information pertinent to analysis. Questionnaires are mailed to builders. The principal sources for obtaining cost data are builders and developers. It is generally advisable to collect data in conjunction with new construction.
- *Sales data* must be sufficient enough to provide a representative sampling of comparable sales needed to apply the market data approach, to derive unit land values and depreciation indicators needed to apply the cost approach and to derive gross rent multipliers and elements of the capitalization rate needed to apply the income approach.

All sales data should include the parcel identification number, property classification code, month and year of age, selling price, source of information, i.e., buyer, seller, agent, or fee and a reliable judgment as to whether or not the sale is representative of a true arm's length transaction. Sales data should be recorded on the same form (assigned property record card) used to record specific property data and verified during the property-listing phase.

The principal source for obtaining sales data is the Register of Deeds Office and the real estate transfer returns. Other sources may include developers, Realtors, lending institutions and individual owners during the listing phase of the operation,

- *Income and expense data* must be sufficient enough to derive capitalization rates and accurate estimates of net income needed to apply the income approach. Income and expense data should include both general data regarding existing financial attitudes and practices and specific data regarding the actual incomes and expenses realized by specific properties. The general data should include such information as equity return expectations, gross rentals, vacancy and operating cost expectations and trends, prevailing property management costs and prevailing mortgage costs. Specific data should include the parcel identification number, property address (or building ID), source of information, the amount of equity, the mortgage and lease terms and an itemized account of the annual gross income, vacancy loss and operating expenses for the most recent two-year period.

The general data should be documented in conjunction with the development of capitalization procedural guidelines. The specific data, since it is often considered confidential and not subject to public access, should be recorded on special forms, designed in such a way as to accommodate the property owner or agent thereof in submitting the required information. The forms should also have space reserved for the appraiser's analysis and calculations.

The principal sources for obtaining the general financial data are investors, lending institutions and property managers. The primary sources for obtaining specific data are the individual property owners and/or tenants during the listing phase and the appeals phase of the reappraisal effort.

- *Neighborhood data.* At the earliest feasible time during the data inventory phase of the operation and after a thorough consideration of the living environment and economic characteristics of the overall county, or any political sub-division thereof, the appraisal staff should delineate the larger jurisdictions into smaller "neighborhood units," each exhibiting a high degree of homogeneity in residential amenities, land use, economic trends and housing characteristics such as structural quality, age and condition. The neighborhood delineation should be outlined on an index (or comparable) map and each assigned an arbitrary Valuation Control Section Number (VCS) , which when combined with the parcel identification numbering system, will serve to uniquely identify it from other neighborhoods.

Neighborhood data must be comprehensive enough to permit the adequate consideration of value-influencing factors to order to understand the variations in selling prices and income yields attributable to benefits arising from the location of one specific property as compared to another. The data should include the taxing district, the school district, the VCS number, special reasons for delineation (other than obvious physical and economic boundaries) and various neighborhood characteristics such as the type (urban, suburban, etc.), the predominant class (residential, commercial, etc.), the trend (whether it is declining, improving, or relatively stable), its accessibility to the central business district, shopping centers, interstate highways and primary transportation terminals, its housing characteristics, the estimated range of selling prices for residentially-improved properties and a rating of its relative durability.

All neighborhood data should be recorded on a specially designed form during the delineation phase. The existing property record card can serve in this capacity as it contains the current data on file.

- *Specific property data* must be comprehensive enough to provide the database needed to process the characteristics of each parcel into an indication of value, to generate the tax roll and related tax roll requirements, to generate other specified output and to provide the assessing officials with a

permanent record to facilitate maintenance functions and to administer taxpayer assistance and appeal proceedings.

The data should include the parcel identification number, ownership and mailing address, legal description, property address, property classification code, local zoning code, neighborhood identification code, site characteristics and structural characteristics.

All the data should be recorded on a single, specially designed property record card customized to meet individual assessing needs. Each card should be designed and formatted in such a way as to accommodate the listing of information and to facilitate data processing. In addition to the property data items noted above, space must be provided for a building sketch, land and building computations, summarization and memoranda. In keeping with the economy and efficiency of a mass appraisal program, the card should be formatted to minimize writing by including a sufficient amount of site and structural descriptive data which can be checked and/or circled. The descriptive data should be comprehensive enough to be suitable for listing any type of land and improvement data regardless of class, with the possible exception of large industrial, institutional and utility complexes which require lengthy descriptions. In these cases, it will generally be necessary to use a specially designed supplemental property record document, keyed and indexed to the corresponding property record card. The property record card should be made a permanent part of the assessing system and used not only in conjunction with the revaluation, but also to update the property records for subsequent assessments.

The specific property data should be compiled from existing assessing records and field inspections. The parcel identification number, ownership, mailing address and legal description may be obtained from existing tax rolls. Property classification codes may also be obtained from existing tax rolls (whenever available) and verified in the field. Local zoning codes may be obtained from existing zoning maps. Neighborhood identification codes may be obtained from the neighborhood delineation maps. Lot sizes and acreage may be obtained from existing tax maps. The property address and the site and structural characteristics may be obtained by making a physical inspection of each property.

During the measuring and listing phase of the operation, the appraiser must visit each property and try to make personal contact with the occupant. In the course of the inspection, the following procedures must be adhered to.

- Verify the identification of the property (parcel ID or PIN).
- Verify the ownership (recording any transfers which may have occurred).
- Record or confirm the property's situs address.
- Verify the property classification.
- If possible interview the occupant of the building and record all pertinent economic data.
- Verify the exterior measurements and inspect the exterior of the building, as well as all other improvements on the property and record the story height and the dimensions and/or size of each.
- Record a sketch of the principal building(s), consisting of an overhead view showing the main portion of the structure along with any significant attached exterior features, such as porches, etc. All components must be identified and the exterior dimensions shown for each.
- Select and record the proper "grade" of the improvement (construction quality).
- Select and record the proper replacement costs or replacement cost adjustments for all field priced items.
- Review the property record card for completeness and accuracy.
- Take photo of building

After the field inspection is completed, the property record cards must be submitted to data entry personnel to update any changes made in the field to property record in the CAMA system.

Complete and accurate data are essential to the program. Definite standardized data collection and recording procedures must be followed if these objectives are to be met.

## **PROCESSING THE DATA**

This phase of the operation involves the analysis of data compiled during the data inventory phase and the processing of that data to an indication of value through the use of the cost, market and income approaches to value.

During the analytical phase, it will be necessary to evaluate cost, market and income data in order to provide a basis for validating the appropriate cost schedules and tables required to compute the replacement cost new of all buildings and structures; for establishing comparative unit land values for each class of property; for establishing the appropriate depreciation tables and guidelines for each class of property; and for developing gross rent multipliers, economic rent and operating expense norms, capitalization rate tables and other related standards and norms required to effect the mass appraisal of all the property within an entire political unit on an equitable basis.

After establishing the appropriate standards and norms, it is necessary to evaluate the specific data compiled for each property by giving due consideration to the factors influencing the value of that particular property as compared to another and then to process the data into an indication of value by employing the techniques described in the section of the manual dealing with the application of the traditional approaches to value.

Any one, or all three of the approaches, if applied properly, should lead to an indication of market value. The primary concern is applying the approaches on an equitable basis. This requires the coordinated efforts of a number of individual appraisers, each acting as a member of a team, with the team effort directed toward a valid, accurate and equitable appraisal of each property within the County. Each property must be reviewed, during which time the following procedures must be adhered to.

- Verify the property characteristics recorded on the property record card.
- Confirm that the proper schedules and cost tables were used in computing the replacement cost of each building and structure,
- Confirm the determination of the proper quality grade and design factor is applied to each building to account for variations from the base specifications.
- Make an appraisal judgment of the overall condition, desirability and usefulness of each improvement in order to arrive at a sound allowance for depreciation.
- If applicable, capitalize the net income capabilities into an indication of value in order to determine the loss of value attributable to functional and economic obsolescence.
- Confirm that the depreciated value of all improvements has been added to the land value and review the total property value relative to the value of comparable properties.
- Confirm that the total property value established can be correlated to actual sales of comparable properties.

Once the final values have been established for each property, the entire program should be evaluated in terms of its primary objectives; do the values reflect a satisfactory level of market value and what's more

important, are the values equitable? Satisfactory answers to these questions can best be obtained through a statistical analysis of recent sales in an assessment/sales ratio study, if sufficient sales are available.

To perform the study, it is necessary to take a representative sampling of recent valid sales and compute the assessment-to-sale ratio for each of the sales. If the *sample* is representative, the computed median assessment-to-sale ratio will give an indication of how close the appraisals within each district approximate the market value. This is providing, of course, that the sales included represent true market transactions. It is then needed to determine the deviation of each individual appraisal-to-sale ratio from the median ratio and to compute either the average or the standard deviation, which will give an indication of the degree of equity within each individual district. What remains then is to compare the statistical measures across property classes in order to determine those areas, if any, which need to be further investigated, revising the appraisal, if necessary, to attain a satisfactory level of value and equity throughout the entire jurisdiction.

The techniques and procedures set forth herein, if applied skillfully, should yield highly accurate and equitable property valuations and should provide a sound property tax base. It should be noted, however, that no program, regardless of how skillfully administered, can ever be expected to be error free. The appraisal must be fine tuned and can best be done by giving the taxpayer an opportunity to question the value placed upon his property and to produce evidence that the value is inaccurate or inequitable. During this time, the significant errors will be brought to light and taking the proper corrective action will serve to further the objectives of the program. What's important in the final analysis is to use all these measures as well as any other resources available to assure the highest degree of accuracy and equity possible.

***NEW CONSTRUCTION PERCENTAGE OF COMPLETION GUIDE***

This guide is to be used in estimating the percentage of completion of both residential and commercial buildings under construction.

	PERCENT OF TOTAL	CUMULATIVE PERCENT OF TOTAL	PERCENT COMPLETE
1. Plans, permits and survey	2	2	
2. Excavation, forms, water/sewage hookup	4	6	
3. Concrete	8	14	
4. Rough framing	21	35	
5. Windows and exterior doors	2	37	
6. Roof cover	3	40	
7. Rough-in plumbing	4	44	
8. Insulation	1	45	
9. Rough-in electrical and mechanical	11	56	
10. Exterior cover	6	62	
11. Interior drywall and ceiling finish	8	70	
12. Built-in cabinets, interior doors, trim, etc	13	83	
13. Plumbing fixtures	5	88	
14. Floor covers	3	91	
15. Built-in appliances	3	94	
16. Light fixtures and finish hardware	2	96	
17. Painting and decorating	4	100	
 TOTAL	 100%		

Signature \_\_\_\_\_ Date \_\_\_\_\_

As near as possible, it is essential to estimate the percentage of completion as of January 1 of the year for which the appraisal is being made and for which taxes on the value of the new construction will be levied.

## INTRODUCTION

This section is provided to establish general guidelines and procedures in the identification (delineation) of residential and commercial neighborhoods.

Definition of a “Neighborhood” or VCS (Valuation Control Section).

**A set of parcels within a specific geographical area, where the parcels share a high degree of homogeneity, the environment of which has a direct and immediate impact on the value of the parcels within its boundary.**

The following points are noted:

- Ideally, it is the smallest geographic unit that can be defined as a single area in which property characteristics for all parcels are qualitatively homogenous.
- The term is primarily an urban and suburban concept. However, it may be extended to rural areas.
- Neighborhoods are characterized by the activities or operations that are carried on within its borders.
- The boundaries of a neighborhood must be delineated for the purpose of analysis. The types of boundaries are:
  - natural, (including rivers, hills, lakes, ravines and undeveloped areas)
  - manmade (streets, highways, roads, railroad tracks, rights-of-way, subdivision boundaries) and
  - political (city limits, school districts, zoning districts)
  - predominant land use and anticipated changes
  - housing characteristics (type, quality, age and condition)

There are four forces, or sets of factors, to be addressed in neighborhood analysis: physical, economic, governmental and social. They must be analyzed specific to their impact on each neighborhood.

It should be noted that mere size does not determine a neighborhood, although large area neighborhoods have the advantage of better protection from infiltration of inharmonious influences or detrimental property uses from adjoining properties.

## NEIGHBORHOOD DESCRIPTION CODE

The appraisal technique for both residential and commercial properties, employed for assessment purposes, is mass appraisal. That is, within a neighborhood a large number of sales are analyzed and the results applied to a larger number of parcels within the same neighborhood. Neighborhood grouping allows for comparable neighborhoods that are not contiguous to one another to share sales data. Results are applied to a particular group of properties (neighborhood), rather than to individual properties.

The mass appraisal process requires every parcel be assigned to a “neighborhood” or VCS number. This assignment number, or neighborhood description code, links properties of like characteristics for neighborhood grouping and subsequent market analysis and development of land rate tables. The large number of neighborhood descriptions (approximately 884 residential and 190 commercial) prohibits their inclusion in this document, but are on file in the Randolph County Tax Office.

The “Neighborhood description” number is can be an alpha-numeric field and is user-defined.

Commercial/Industrial neighborhoods (VCS) are assigned unique VCS numbers that best identify the types of properties located in the neighborhood. Commercial/Industrial neighborhoods (VCS) first character will be a zero (0). The last digit will identify the type most representative of the neighborhood.

The types are: (1) **CENTRAL BUSINESS DISTRICT** to indicate the core is in the center of a city in which is concentrated the major retail, financial, governmental, professional and services activities of the city. In many instances, these boundaries have already been established or defined by city planners or other agencies.

- (2) **PERIMETER CENTRAL BUSINESS DISTRICT** to indicate the outer boundaries of the central business district or core area in which the concentration of major mercantile activity is significantly less pronounced.
- (3) **BUSINESS CLUSTER** to indicate a cluster or number of commercial Properties grouped together due to some attracting force (such as major intersection of interstate highways or a major shopping mall.)
- (4) **MAJOR STRIP** to indicate the type of commercial development in which major thoroughfares are bordered by an almost continuous row or strip of retail stores and allied service establishments.
- (5) **SECONDARY STRIP** to indicate row or strip type commercial development bordering secondary arteries.
- (6) **NEIGHBORHOOD OR SPOT** to indicate -
  - A – dwellings located in primarily residential areas
  - B - for commercial properties, individual or scattered commercial establishments located in basically residential area.
- (7) **COMMERCIAL/INDUSTRIAL PARK** to indicate a controlled park-like development designed to accommodate specific light industrial and mercantile properties and containing the required utilities, streets and other appurtenances.
- (8) **INDUSTRIAL SITE** to indicate land or land and improvements (not located in an established industrial park) adaptable for industrial use. Normally, this is a combination of land, improvements and machinery intended for the

assembling, processing and manufacturing of products of natural resources.

- (9) APARTMENT/CONDOMINIUM COMPLEX to indicate the property is an apartment or condominium complex site.

Residential neighborhoods (VCS) numbers are to identify a set of parcels for market analysis and land table rates assigned randomly or sequentially because its only purpose is ease of “Neighborhood Grouping.”

The steps involved in the assignment of the Neighborhood Description Code are as follows:

1. Identify and locate surveyed tracts and subdivisions  
Assign a numerical identification code to the areas  
Enter the assigned identification code into the individual parcels
2. Identify and locate non-surveyed tracts and subdivisions.  
Assign an unused numerical identification code to the areas.  
Enter the assigned identification code into the individual parcels
3. Identify and locate major pockets (clusters) of properties.  
Breakdown the pockets (clusters) by like neighborhood characteristics.  
Assign an unused identification code to each identified area.  
Enter the assigned identification code into the individual parcels
4. Identify and locate rural areas of like neighborhood characteristics.  
Assign and unused numerical identification code to the areas.  
Enter the assigned identification code into the individual parcels
5. Identify all properties that are without a neighborhood description code.  
Assign to the identified properties an unused numerical identification code or to an existing identification code of like characteristics.  
Enter the assigned identification code into the individual parcels

**GENERAL DISCUSSION:**

The property tax is an *ad valorem* tax (according to value) and because value is defined as "market" value and because market value is evaluated by measuring "sales" of properties in the market place, then the quality of a group of assessments may be evaluated by measuring their ratio to the real estate sales from the same geographical area as of the assessments. This process of comparing appraised values to sale prices is called the assessment/sales ratio study.

**DEFINITION:**

The word "ratio" is a statistical term that, when numerically expressed, simplifies the comparison of magnitude of numbers. There are various types of ratios, distinguished by their base of comparison, that is the denominator of the fraction and they may take the form of fractions, proportions, percentages or rates. Some of the leading types of ratios are the results of comparing a part to its whole, comparing a part to a part within a whole, or comparing one whole to another whole.

**SALES RATIO STUDY:**

The Randolph County Tax Office has a straight forward purpose -- to value all properties uniformly and equitably. Therefore, it is incumbent on the staff appraiser to place property values that represent the current probable selling price or some constant fraction thereof.

The ratio study has been found to be a useful and meaningful tool in measuring the quality of the real property appraisals. The measurements (commonly referred to as ratio studies and median assessment levels) can be either in the aggregate or sectional and are found by comparing the value placed on properties which have sold with the amount for which the property actually sold.

Again, it is important to stress caution when reviewing sales ratio results for the properties that make up a sales file which does not always constitute a representative sample of the property type (class) population within the County. The calculated results could be biased, even if carefully weighted for some important classes of properties are seldom, if ever, sold.

The Sales Analyst collects and analyzes market information that is either qualified or disqualified for sales ratio and valuation. Only "arm's length" transactions are used to establish market value. Transactions that are results of a foreclosure or short sale are not considered in determining market value or schedule of values.

**STEPS IN THE SALES REVIEW PROCESS**

1. Identify the parcels that have ownership transfer through deeds and MLS
2. Review of the sold properties and code each transaction accordingly. Ones that are obviously invalid or disqualified such as foreclosures, family, or related parties are coded as such.
3. Verification of the remaining sales then begins. This is accomplished several ways:
  - (1) all buyers are mailed questionnaires
  - (2) review of MLS
  - (3) telephone confirmation
4. Review the returned sales confirmation questionnaires; listing the owners state purchase Price and disqualify/qualify as a result of the replies.

## DEED EDIT SHEET

### CODE REASONS FOR REJECTION:

- A. The transaction includes the conveyance of two (2) or more parcels.
- B. Sales for which the improvements sold are not included in the tax assessment or the assessment included improvements built after the sale.
- C. Deed shows \$6.00\* or less in revenue stamps. \*Transaction is for \$3,000 or less.
- D. The date the deed was made, entered or notarized is outside the dates of the study period. (The study period runs from January 1 to December 31.)
- E. The transaction is between relatives or related businesses.
- F. The grantor is only conveying an undivided or fractional interest to the grantee.
- G. The deed reserves unto the grantor, a life estate or some other interest.
- H. The deed reserves unto the grantor the possession of or lease of, the property for specified period following the sale.
- I. One or both of the parties involved in the transaction is governmental, a public utility, lending institution, or a relocation firm.
- J. The deed conveys a cemetery lot or other tax-exempt property.
- K. One or both of the parties involved in the transaction is a church, school, lodge, or some other educational organization.
- L. The deed indicates that the property conveyed is situated in more than one county.
- M. The transaction is for minerals, timber, etc., or the rights to mine or cut same.
- N. The transaction includes the conveyance of personal property and the value of such is not specified separate from the real property value in the deed.
- O. The transaction is the result of a forced sale or auction.
- P. Transaction made by the use of a Contract for Deed, the agreement for which is executed and sale actually made prior to the study.
- Q. The transaction involves the trade or exchange of real property.
- R. The transaction is for real property, which cannot be clearly identified on the county tax records.
- S. Other (An explanation must be provided when this code is used).
- T. Appraised Value has not been determined (new construction/split).