LPA

PERFORMANCE AUDIT REPORT

Property Valuation in Kansas: Reviewing the Valuation of Agricultural and Commercial Properties

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
March 2005

05-04

Legislative Post Audit Committee
Legislative Division of Post Audit

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We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. Government Accountability Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

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March 4, 2005

To: Members, Legislative Post Audit Committee

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Representative Peggy Mast	Senator Nick Jordan
Representative Bill McCreary	Senator Derek Schmidt
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This report contains the findings, conclusions, and recommendations from our completed performance audit, *Property Valuation in Kansas: Reviewing the Valuation of Agricultural and Commercial Properties*.

The report also contains appendices showing a comparison of commercial properties within counties, examples of the cost method calculation for commercial and agricultural properties, and an update on our 2002 audit on Commercial office buildings that didn't appear to reflect their fair market values.

The report includes recommendations for the Department of Revenue to develop guidelines and implement procedures to oversee changes that counties will make to the new computer system, once implemented. We also recommended for several legislative committees to receive testimony and consider amending the State laws to institute a tax roll-back or other options cited in the report to prevent certain tax breaks resulting from reclassifying land, and to clarify the definition of land used for agricultural or recreational purposes. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton

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Legislative Post Auditor

READER'S GUIDE

Get the Big Picture

Read these Sections and Features:

1. **Executive Summary** - an overview of the questions we asked and the answers we found.
2. **Conclusion** and **Recommendations** - are referenced in the Executive Summary and appear in a box after each question in the report.
3. **Agency Response** - also referenced in the Executive Summary and is the last Appendix.

Helpful Tools for Getting to the Detail

- In most cases, an "**At a Glance**" description of the agency or department appears within the first few pages of the main report.
- **Side Headings** point out key issues and findings.
- **Charts/Tables** may be found throughout the report, and help provide a picture of what we found.
- **Narrative text boxes** can highlight interesting information, or provide detailed examples of problems we found.
- **Appendices** may include additional supporting documentation, along with the audit **Scope Statement** and **Agency Response(s)**.

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EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

Overview of Property Valuation in Kansas

The Kansas Constitution mandates a system in which real property is assessed and valued uniformly. *The Constitution established assessment rates for 7 classes of real property such as residential, agricultural, and commercial properties, and requires the Legislature to provide for a uniform and equal basis of valuation. The law mandates all classes of real property to be valued based on fair market value, except agricultural land, which is valued based on its productivity, or use, as specified in the Constitution. For 2003, the total appraised value of the State's real property was slightly more than $131 billion, with an assessed value of $20.7 billion.* .... page 3

Counties are responsible for appraising most properties, with oversight provided by the State. *By law, each county is a separate appraisal district under the Statewide program. County appraisers are responsible for discovering, listing, appraising, and maintaining records of most taxable and exempt real and personal property. The Division of Property within the Department of Revenue carries out its oversight responsibility by conducting compliance reviews, offering training, and providing directives to clarify or establish Statewide policy on appraisal practices and procedures.* .... page 4

A new computer system for calculating appraisal values is being phased in. *The original Computer Assisted Mass Appraisal system (CAMA) implemented in the late 1980's has become seriously outmoded, and the Division plans to finish installing the new, more flexible ORION system in all counties by 2009.* .... page 5

Question 1: Are County Appraisers in Kansas Valuing Commercial Properties and Farm Structures According to the Law and Guidelines Established by the State's Division of Property Valuation?

Nearly all counties are in compliance with State appraisal guidelines. *On a Statewide basis, only three counties were out of compliance for the overall 2004 compliance review. In addition, for a sample of properties across eight counties, appraisers followed the guidelines we reviewed.* .... page 7

Even when appraisers follow all guidelines, seemingly-similar properties can be valued very differently. *The CAMA system calculates both a cost-based value and an income-based value for nearly all commercial properties. Because the income and cost methods determine appraisal values using different factors, the results can be very different and appraisers have to decide which value best reflects the fair market value of a particular property. In addition, many of the factors used within both the cost and income methods are based on appraiser judgment.* .... page 8

All the differences in value in our within-county comparisons of commercial buildings seemed justified. *We examined records for 18 pairs of mini-storage facilities and convenience stores in eight counties. Differences in the infrastructure quality, construction materials, and location explained the differences that initially appeared to be too large, too small, or that went the wrong direction.* .... page 10

Differences in value in our within-county comparisons of agricultural structures seemed justified. *We reviewed 11 pairs of pole sheds and harvest store silos. We learned that unexpected differences in values between the structures were due to economy of scale, age, grade and condition, as well as additional features (such as a cement floor in a pole shed).* .... page 13

Comparisons of values across counties reflect appraisers' decisions about market conditions; most seemed justified, but some were questionable. *Differences in cost indexes (essentially an inflation factor update base costs that were established in the late 1980's) across counties seemed justified. However, we had concerns about the overall use of the cost index, including the application of a residential cost index to agricultural structures.* .... page 14

In addition, many of the variations across counties in base cost rates, expected life measures, and depreciation levels for agricultural structures didn't make sense to us. For example, in Russell County, a pole shed has an expected life of 25 years, while in neighboring Ellsworth County the expected life is 40 years. Counties didn't have documentation available that would have allowed us to determine whether these variations were justified. In addition, we found that appraisers may be making similar undocumented adjustments to county-wide measures for commercial buildings.

Many of the problems we found will be addressed by the new ORION computer system, but the Division needs to ensure it has a process for overseeing adjustments appraisers may make over time.

Question 1 Conclusion .... page 19
Question 1 Recommendations .... page 19

Question 2: Are Landowners Paying Lower Property Taxes on Land Held for Future Development Than They Should?

Land classified as agricultural receives a significant tax break. *The Kansas Constitution specifies that agricultural land must be valued based on its productivity ("use") value, not on its fair market value. This results in a significant tax advantage.* .... page 20

Landowners who get vacant land reclassified as agricultural pay considerably less in taxes. *For 2004, 64 parcels of land were* .... page 20

reclassified from vacant to agricultural land in Johnson and Butler Counties. These reclassifications lowered appraisal values by at least $17 million and reduced property taxes by at least $204,000.

Getting vacant land reclassified as agricultural land is relatively easy, because the State's definition of agriculture is so broad. Our review of files for nine properties that were reclassified showed that county appraisers had documentation justifying the reclassification, and therefore followed all requirements in handling them. However, two of the six reclassified parcels we visited looked questionable to us because one looked like a regular lawn and the other had nothing growing on it.

Some states use a tax roll-back policy to recoup property taxes when agricultural land is reclassified. *Both Nebraska and Texas have tax roll-back policies for agricultural land that changes status. In Nebraska, agricultural land is valued at 80% of fair market value. If the land changes to commercial use, the roll-back policy allows the state to recoup the tax for the current and past three years on the property as if it had been appraised at full fair market value throughout that time. In Texas, owners must pay 7% interest in addition to any net taxes owed when land is reclassified from agricultural land.*

.... page 24

The Kansas Constitution allows the Legislature to institute a tax roll-back policy, which would prevent the loss of tax revenues. Other options for preventing landowner from being able to reclassify vacant land temporarily to reduce their tax obligations include: implementing a "highest and best use" concept for agricultural land, prohibiting reclassification to agricultural use when zoning regulations don't support the use, and instituting a waiting period in connection with required documentation before land is reclassified to agricultural use.

The conclusion and recommendations for this question are at the end of question 3.

Question 3: Is Agricultural Land That Has Been Purchased Primarily for Recreational Purposes Being Classified Correctly?

Land used for recreational purposes is specifically excluded from the definition of agricultural land. *Under the Kansas Constitution, recreational land falls under the classification of "other" property, and is assessed at 30% of its fair market value. This results in significantly higher taxes than if the land were classified as agricultural and assessed at 30% of its use value.*

.... page 26

Non-residents have purchased many large tracts of agricultural land in southeast Kansas in recent years. *Few large tracts of land were purchased by non-residents in the central Kansas counties of Ellis, Russell, and Ellsworth, and county appraisers didn't think there was*

.... page 26

significant use of the land for recreational purposes. However, many non-residents purchased agricultural land in the southeast Kansas counties of Greenwood, Chautauqua, and Elk, and two appraisers in this region expressed concern about such land being used for recreational purposes.

None of the properties we reviewed in southeast Kansas had been reclassified to reflect a change in their use status. *Appraisers cited several reasons why it's difficult to reclassify land even if they think it's being used for recreation. They include:*

- *most land purchased for a recreational use is still primarily used for agricultural purposes.*
- *it's difficult to justify a reclassification because there's no real definition of what qualifies as land "devoted to" agriculture.*
- *it's not worth the effort to reclassify land that is only marginally used for agriculture, because landowners could rightfully claim agricultural use the next year by making only limited changes.*

This audit was conducted by Katrin Osterhaus, Lisa Hoopes, and Brad Hoff. Cindy Lash was the audit manager. If you need any additional information about the audit's findings, please contact Ms. Osterhaus at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at LPA@lpa.state.ks.us.

Property Valuation in Kansas: Reviewing the Valuation Of Agricultural and Commercial Properties

State law requires all real property subject to taxation to be appraised uniformly and equally as to class, and at its fair market value (except agricultural land, which is valued at "use" value).

Recently legislators have heard concerns from constituents about significant variations in values for farm-related property, and commercial property. They cite examples such as some counties placing a high value on harvest store silos and other counties placing little or no value on them. Also, some owners of commercial property have expressed concerns about the level of property tax they pay in relation to what owners of similar property pay in other counties. In addition, legislators have expressed concerns about property being valued at agricultural use when it is being used for recreational purposes. Legislators want to know whether uniform standards are being promulgated and enforced by the Division of Property Valuation as they relate to farm and commercial properties.

This performance audit answers the following question:

Are county appraisers in Kansas valuing farm and commercial properties according to the law and guidelines established by the Division of Property Valuation?

To answer this question, we reviewed applicable sections of the Kansas Constitution, State law, and Division policies and procedures, and reviewed results of the Division's 2004 compliance review. We reviewed appraisal data and visited a sample of commercial properties and agricultural structures in eight counties to determine whether county appraisers followed selected prescribed processes in valuing the properties, and whether variations in value between these properties within and across counties seemed justified.

We also reviewed recent or significant appeals to the Board of Tax Appeals and Kansas Court of Appeals regarding classification of land to see how the State's broad definition of agriculture was being interpreted. We analyzed the tax impact of properties that changed classification from vacant land to agricultural in two growth counties, and reviewed trade publications and talked with officials in other states to identify options to help ensure the tax breaks associated with the agricultural classification aren't received inappropriately. To explore the extent to which land classified as agricultural was being used for recreational purposes, we interviewed appraisers in six counties that are popular hunting destinations, reviewed sales of large tracts of agricultural land in those counties, and what appraisers were doing to ensure the land was still appropriately classified. Throughout this audit, we interviewed Division officials and county appraisers. Finally, we followed-up on the findings from our 2002 audit of commercial property valuations to determine what valuation changes occurred as a result of that audit.

A copy of the scope statement for this audit approved by the Legislative Post Audit Committee is included in Appendix A. For reporting purposes, we've separated the original question into three questions.

In conducting this audit, we followed the applicable government auditing standards set forth by the U.S. Government Accountability Office.

Our findings begin on page seven, following an overview of the appraisal process in Kansas.

In 2003, Kansans paid about $3.1 billion in real and personal property taxes, nearly $2.1 billion of which was for real property. Property taxes fund a variety of governmental activities — primarily those relating to local school districts and local units of government. Because of the huge sums involved, concerns always exist about whether properties are valued in accordance with State law and whether taxpayers are paying their fair share.

The Kansas Constitution Mandates a System In Which Real Property Is Assessed and Valued Uniformly

The *Figure OV-1* shows how different levels of government have contributed to the process for appraising and assessing real property in Kansas.

As specified in the Constitution, agricultural land is valued based on a "use" concept. It applies to land devoted to the production of plants, animals or horticultural products. Below are some helpful definitions:

- **Fair market value** means the amount a well-informed buyer is willing to pay and a well-informed seller is willing to accept for the property in an open and competitive market. Sale price is an important element in establishing fair market value, but it isn't the sole criteria. Determination of fair market value also takes other elements into account, including the effect of location, improvements, and comparison with values of similar property.

- **Agricultural productivity ("use")** means the productive potential of the land. The Division of Property Valuation has adopted a classification system for all land devoted to agricultural use that groups the State into several crop districts, and classifies agricultural land by specific soil types and sloping condition. The Division follows a complex method to arrive at an appraised value for each soil type.

Figure OV-1
Appraisal and Assessment of Real Property

	Assessment	Appraisal
The Kansas Constitution...	*...establishes assessment rates for the seven classes of real property (such as residential, agricultural, and commercial), and requires them to be assessed uniformly based on class.*	*...requires the Legislature to provide for a uniform and equal basis of valuation.* *... requires agricultural land to be appraised on its productivity, or "use."*
The Legislature...	*...has no additional requirements relating to assessment.*	*...requires most property to be appraised at "fair market value," except land devoted to agriculture, which is valued on "use value."*
The Department of Revenue's Division of Property Valuation	*...provides guidelines and rules to local officials responsible for the valuation and assessment of property for tax purposes.*	*...issues directives and training manuals to appraisers that prescribe appraisal methods and standards.* *...conducts a procedural compliance review, including a sales-ratio study, of each county annually.*

Source: Kansas Constitution, statutes, and policies and procedures of the Department

Figure OV-2 Assessment Rates and 2003 Values for Real Property				
Type of Real Property	**Assessment Rate**	**Appraised Value (in billions)**	**Assessed Value (in billions)**	**% of Total Assessed Value**
Public utility real properties (a)	33%	$9.6	$2.9	14%
All other properties not otherwise specifically classified	30%	$0.8	$0.2	0.9%
Commercial properties	25%	$20.1	$5.0	24%
Land owned and operated by a not-for-profit organization	12%	$0.4	$0.05	0.3%
Vacant lots	12%	$1.3	$0.16	0.8%
Residential	11.5%	$94.1	$10.8	52%
Land devoted to agricultural use (b)	30% (b)	$5.2	$1.6	8%
Total		**$131.5**	**$20.7**	**100%**

(a) This category includes railroad real property, which uses the commercial assessment rate.
(b) All types of real property are assessed based on fair market value, except agricultural land, which is valued at "use" value.

Source: Kansas Department of Revenue statistical report of Property Assessment and Taxation

For 2003, the total appraised value of the State's real property was slightly more than $131 billion, with an assessed value of $20.7 billion. *Figure OV-2* shows the assessment rate as well as the appraised and assessed values for each type of real property in 2003.

Counties Are Responsible for Appraising Most Properties, With Oversight Provided By the State

Under State law, each county is a separate appraisal district under the Statewide program. County appraisers, who are appointed by local boards of county commissioners, are responsible for discovering, listing, appraising, and maintaining records of taxable and exempt real and personal property at the local level. According to State law, all properties must be viewed and inspected once every six years.

The Division of Property Valuation has oversight responsibility for county appraisers, and direct responsibility for valuation of public utilities (such as power and telephone companies) and motor carriers.

The Division carries out its oversight by conducting an annual compliance review that assesses whether each county is following correct valuation procedures — from appraising properties to sending out tax notices on a timely basis. The review includes the county's results from the Division's sales-ratio study. That study determines, for residential and commercial properties that sold recently, whether the county appraisal values were sufficiently close to the actual sales prices.

Counties that fail to meet the Division's compliance standards are provided with guidance, and repeated failure to meet compliance standards can result in the Division requiring a reappraisal of all property in the county.

In addition to oversight, the Division also provides training for county appraisers and issues directives to clarify or establish Statewide policy on appraisal practices and procedures.

A New Computer System for Calculating Appraisal Values Is Being Phased In

To complete the Statewide property reappraisal ordered by the Legislature in 1985, the State implemented a computer-assisted mass appraisal system known as CAMA. County appraisers enter detailed information about each property into the system, as well as a variety of information specific to the county as a whole, such as inflation in building costs, market data, and the like. The CAMA system has become seriously outmoded, and the Division began efforts to replace it in 1997.

A new system, named ORION, was developed at an estimated cost of $3.8 million. Division officials stated that ORION will give appraisers improved analytical tools to produce better estimates of market values, and the ability to store multi-year information in its database. ORION was installed and tested in three counties in 2004, and seven more counties are scheduled for installation in 2005. The new system is to be fully implemented Statewide by 2009.

The Kansas Department of Revenue
Division of Property Valuation
AT A GLANCE

Purpose: The Division of Property Valuation administers the property valuation program; provides valuation guidelines, rules, and training to county appraisers; administers the new registered mass appraiser designation program; and prepares the annual sales/assessment ratio study that measures the accuracy and uniformity of appraisals.

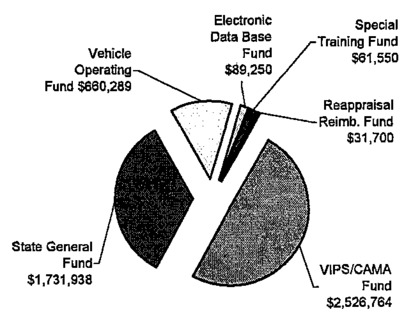
Staffing: The Division has 76 full-time-equivalent positions, which includes 26 staff members who provide support and oversight to county appraisers.

Budget: About half the Division's funding comes from the VIPS/CAMA Fund. For the most recent year, the Division spent $5.1 million, as shown below.

FY 2004 Expenditures

Type	Amount	% of Total
Salaries/Wages	$3,432,805	67%
Contractual Services	$1,469,996	29%
Commodities	$97,097	2%
State Aid to Local Units	$58,655	1%
Capital Outlay	$42,938	1%
Total Expenses:	**$5,101,491**	**100%**

Sources for Funding for Expenditures



Total Funding: **$5,101,491**

Source: Department of Revenue

Question 1: Are County Appraisers in Kansas Valuing Commercial Properties and Farm Structures According to the Law and Guidelines Established by the State's Division of Property Valuation?

ANSWER IN BRIEF:	*Nearly all counties are in compliance with State appraisal guidelines. Even when appraisers follow all guidelines, seemingly-similar properties can be valued very differently. All the differences in value in our within-county comparisons of commercial buildings and agricultural structures seemed justified. Comparisons of values across counties reflect appraisers' decisions about market conditions; some seemed justified, but others were questionable. These and other related findings are discussed in more detail in the sections that follow.*

Nearly All Counties Are in Compliance With State Appraisal Guidelines

To determine whether counties are valuing properties accurately and are in compliance with State-mandated procedures, the Division of Property Valuation performs the following annual reviews on each county:

- Sales-Ratio study: This study provides statistical information about residential and commercial properties sold during the year. The study measures accuracy and uniformity by reviewing how close properties' selling prices were to their appraised values, and how uniformly properties had been appraised.
- Substantial Compliance review: This review is an overall assessment of counties' procedures for appraising property, and includes the results from a county's sales-ratio study. To pass the compliance review, a county must receive a score of 75%.

On a Statewide basis, only three counties were out of compliance for the overall 2004 compliance review. According to the Division's review, all three failed to achieve compliance because of problems with their sales-ratio data. One of the three, Chautauqua County, was in the group of eight counties we reviewed for this audit. Chautauqua had an overall score of 66.7%, which didn't meet the minimum 75% passing rate.

For a sample of properties we reviewed, appraisers followed the guidelines we reviewed. To value properties using up-to-date information, appraisers must conduct several studies periodically. For a sample of 62 properties (38 commercial properties and 24 agricultural structures), we checked if county appraisers had correctly applied data outcomes from the following two studies:

- Market analysis: measures average market rent, expenses, vacancy and capitalization rates applicable to neighborhoods for all classes of income-producing property such as stores, apartments, and office buildings.

- Cost index study: measures inflation in the cost of building for the particular county. The data are used to reflect the current cost of rebuilding a structure.

We found that county appraisers applied the data from these studies for all but seven properties. And in all seven cases, they provided reasonable explanations for why they thought it was necessary to either deviate from their study data, or totally override the appraisal value generated by CAMA to arrive at what they thought was a fair market value for the property. The adjustments they made:

- in four cases they adjusted rental rates, expense rates, or other factors that go into the computer model because of additional information they had about the property, often from previous appeal hearings or from their general familiarity with the property.

- in three cases appraisers used neither the cost value nor the income value generated by CAMA. In one case, for example, the income method resulted in a much higher value for the property than it had been appraised at the previous year, while the cost method resulted in a significant drop in the property's value. In the appraiser's opinion, the property hadn't changed in value, so she overrode the system and used the value generated by CAMA the previous year.

Even When Appraisers Follow All Guidelines, Seemingly-Similar Properties Can Be Valued Very Differently Simply Based on the Valuation Method Used

The Division's current system was implemented to provide for annual mass appraisal of real property, a tool to reduce the bias and lack of uniformity that can occur with individual appraisal of property. Still, the computer system isn't intended to replace appraisers' professional judgment.

The appraised value of a commercial property can vary significantly depending on whether the cost method or the income method is used. The income method determines value by estimating how much income a property would generate. The cost method determines value by estimating the replacement cost of the property minus depreciation. The box on page 9 contains more information about these valuation methods.

Because each method uses different factors to arrive at a value, they can result in very different outcomes. For example, factors such as land values, improvements made to the premises, and the age or construction quality may have more or less impact depending on which method is used.

The CAMA system calculates both a cost-based value and an income-based value for nearly all commercial properties. Division officials told us it would be a coincidence if the results matched because the methods measure different things. Appraisers have to decide which value, in their opinion, best reflects the fair market value of the property.

Appraisers Use One of Three Methods To Value Property

The income method is the preferred method for valuing commercial properties if reliable data are available. It's based on the idea that investors buy property for the rental income it will produce. A property's value is determined based on typical rental rates, expenses, vacancy levels, and "capitalization" rates (similar to a rate of return on an investment) for that type of property. In general, the newest and nicest buildings would be expected to have higher rental rates, lower expenses, lower vacancy rates, and lower capitalization rates.

To use the income method successfully, counties must collect, maintain, and carefully analyze actual income and expense data from commercial properties to develop typical rates that can be used in models. County appraisers can obtain those data in several ways - through survey questionnaires or direct contact, property appeal hearings, or market publications.

The cost method can be used to value commercial properties when the income method can't be used or produces unreasonable results. The cost method also is used to value agricultural structures. It determines value based on the cost of rebuilding - including improvements, but minus depreciation. Appraisal literature suggests that, as a building ages, it becomes harder to generate an accurate estimate of value using the cost method because it's difficult to accurately estimate how much the building has depreciated.

The sales comparison method is mostly used for residential properties. It arrives at an appraisal value by comparing a property with similar properties that have sold recently. Reliability of the sales method rests on the number and quality of available sales. Any sales that are deemed not to be an "arms-length" transaction are excluded from the analysis.

Figure I-1 on the next page shows a few examples of the variations that can result. Although the industry recognizes the income method as the preferred tool for valuing commercial properties, that method works best when its rates are based on information from a large number of similar properties. In many counties in Kansas, that information is difficult to come by. As a result, appraisers often rely on the cost method for valuing commercial properties.

In addition, the current computer system prohibits appraisers from using the income method when properties have multiple classifications, for example, a convenience store that has residential space. To value those properties, appraisers must use the cost method or apply an override value. According to county appraisers we spoke with, this is a big limitation but will be easier to address when the new appraisal system is implemented.

Figure I-1
Comparison of Cost and Income Method Values on Same Property
(The shaded values represent the values chosen by the appraiser)

Property Name	City	Cost Method	Income Method	Percent Difference in Value Between the Cost and Income Methods
Kleppers Korner Store	Manhattan	$251,190	$254,500	1%
Tower Wholesale	Russell	$211,730	$177,900	17%
USA Express	Russell	$66,630	$87,900	28%
Shop Quik Texaco	Manhattan	$666,760	$327,900	68%
Casey's	Marysville	$120,000	$31,700	116%
Casey's	Hays	$419,180	$91,000	129%
Source: Inventory sheets of selected properties provided by county appraisers				

Many of the factors used in both the cost and income methods are based on appraiser judgment. A few factors used in the calculations are strictly factual (such as age or building size), or involve applying the same data to every property (such as the county index). Most others involve appraiser judgment. For example, appraisers judge factors such as a property's physical and functional characteristics, the quality of building materials used, and the effect of the property's location based on their training, knowledge, and experience.

Similarly, appraisers can, and should, deviate from data obtained in their market studies if they think those data aren't appropriate for a particular property. As mentioned earlier, the appraiser also has the flexibility to "override" a property's value, using neither the cost value nor the income value generated for that year.

All the Differences We Saw In Values For Commercial Buildings Within Our Comparison Counties Seemed Justified

We examined records for 18 pairs of mini-storage facilities and convenience stores in eight counties. Both properties in each pair were located in the same county, but not necessarily in the same city. Our sample included properties that:

- were relatively similar in age and grade, but had large variances in appraised values per square foot.
- were considerably different in age and/or grade, but had similar appraised values per square foot.
- had opposite values per square foot of what we would have expected: For example, an older building had a higher value than a newer building.

For these comparisons, we looked to see whether the trends we saw were justified.

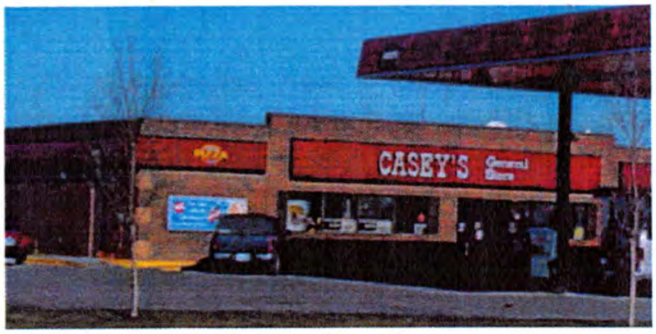
Differences in the infrastructure quality, construction materials, and location explained the differences that initially appeared to be too large, too small, or that went the wrong direction. For these properties, we reviewed, records, reviewed the properties' appearance, and talked to the appraisers to understand some of the differences in appraised values between the properties.

Figure I-2 summarizes information for four pairs of buildings. Appendix B shows all commercial properties we reviewed.

Figure I-2
Comparison of Commercial Properties Within Counties

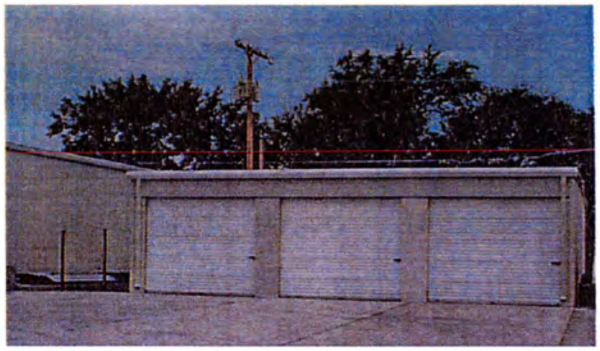
Property	City	Year Built	Grade	Building Value/Sq. Ft.	Factors That Contributed to the Difference in Appraised Value
Casey's #1	Hays	2000	B-	$50.34	Infrastructure quality and age. Casey's #1 has central air conditioning, while Casey's #2 has a window unit. Also, Casey's #2 had been depreciated more because it's three years older. *(See pictures on page 12.)*
Casey's #2	Hays	1997	B-	$44.88	
Mini-warehouse	Hays	2002	D-	$15.88	Infrastructure quality and grade. Self-Stor Downtown has more overhead doors, leading to a higher base cost/square feet. Self-Stor's slightly higher grade created the additional difference in appraisal value between the two buildings. *(See pictures on page 12.)*
Self-Stor Downtown	Hays	2003	D	$19.21	
Briar Patch Storage	Cedarville	1994	C	$6.51	Location. Even though Briar Patch Storage in Cedarville has a higher grade, its neighborhood rating is very low because it's located in a very small town with little demand, compared to the Briar Patch in Sedan, which is the county seat.
Briar Patch Storage	Sedan	1994 & 1998	D	$8.90	
J & E Storage	Victoria	2001	D-	$10.75	Location. J&E is 24 years newer than Miniwarehouse, but is located in an area with low demand for storage units. Also, Miniwarehouse has a slightly lower base price and significant depreciation.
Mini-warehouse	Victoria	1977	D-	$10.15	

Source: LPA analysis of inventory data sheets of sample commercial properties provided by county appraisers.



Casey's #1 ($50.34/sq.ft.) Casey's #2 ($44.88/sq.ft.)

Although the buildings looked alike, Casey's #1 is three years newer and has central air conditioning, while Casey's #2 only has a window air conditioning unit, which results in the variance in appraised value/square foot.

Self-Stor Downtown ($19.21/sq.ft.) Miniwarehouse ($15.88/sq.ft.)

Self-Stor Downtown has more overhead doors compared to the Miniwarehouse, which leads to a higher base cost/ square foot. In addition, Self-Stor has a higher grade. Both factors caused the variance in appraised value/square foot.


Pole shed #1 (1.96/sq.ft.) Pole shed #2 ($2.51/sq.ft.)

Both pole sheds have the same age, grade and condition, but pole shed #2 has a concrete floor, which caused most of the variance in appraised value/square foot.

This silo in Russell County had no value because its top was blown off in a tornado.

The Differences We Saw In Values for Agricultural Structures Within Our Comparison Counties Also Seemed Justified

We reviewed eight pairs of pole sheds and three pairs of harvest store silos that also had seemingly-unexpected variations in value, given their relative similarities in age, grade, and condition. These agricultural buildings had relatively low appraisal values–for example, values on pole sheds we reviewed ranged from $300 to $4,200, and silos ranged from no value to $10,550. These values translated to a maximum of $4 per square foot, far less than the values for commercial structures.

We identified three overriding causes affecting the value of agricultural structures, which explained the differences in values we saw. All agricultural structures are valued using the cost approach, but the formula is somewhat different from commercial buildings valued based on cost. Here's what we learned:

- Economy of scale. To calculate the base cost on any agricultural structure, the formula is designed to create a lower value per square or cubic foot for a larger structure, because the cost to build doesn't increase proportionately as building size increases. We found this factor to be present in all comparisons, sometimes accounting for only a small part, and sometimes accounting for all of the value differences we saw.

- Age, grade and condition. After the base value of an agricultural structure is established, the final appraisal value is driven by age, grade, and condition of the structure. Therefore, even small differences in these factors caused - or significantly contributed to - the value differences we saw.

- Additional features. The CAMA system allows appraisers to increase a structure's base cost based on certain modifications, such as concrete floors or insulation in pole sheds, or automatic unloaders or augers on silos.

Figure I-3 on the next page summarizes information for three pairs of agricultural structures.

Appraisers can choose to assign no value to agricultural structures. Because of concerns about some agricultural structures having zero value, we reviewed the reasons for why this may happen. We learned that structures that don't contribute value to the property can be determined to have no value. While the Division provides some guidance on this, it's up to appraisers to make that decision. For example, one county appraiser told us he may assign no value to older pole sheds that are too small to house newer, larger farm equipment.

The picture on page 12 shows a zero-value silo that had its top blown off making the structure unusable.

Figure I-3 Comparison of Agricultural Structures Within Counties						
Structure	County	Year Built	Grade	Condition	Structure Value per Cu. Ft. or Sq. Ft.	Factors That Contributed to the Difference in Appraised Value
Silo #1	Marshall	1983	C	A	$0.19	Economy of Scale. Silo #1 was more than twice as tall (87 feet vs. 40 feet), resulting in a lower base cost per cubic foot for that silo. The age difference wasn't a factor because both silos were past their economic life.
Silo #2	Marshall	1975	C	A	$0.28	
Pole Shed #1	Greenwood	1990	C	A	$1.96	Additional feature and economy of scale. Pole shed #2 has a concrete floor, which results in a difference of 47¢/ sq. ft. Economy of scale caused the remaining 8 ¢ difference. *(See pictures on page 12.)*
Pole Shed #2	Greenwood	1990	C	A	$2.51	
Pole Shed #1	Riley	1990	D	F	$0.62	Additional feature, condition, and age. Pole shed #2 has a concrete floor, is in better condition, and is seven years newer.
Pole Shed #2	Riley	1997	D	A	$3.36	
Source: LPA analysis of inventory data sheets of sample agricultural structures provided by county appraisers.						

Comparisons of Values Across Counties Reflect Appraisers' Decisions About Market Conditions; Most Seemed Justified, But Some Were Questionable

One concern behind this audit related to variations in values for similar properties across counties. Neither the Constitution nor State law requires valuations to be similar from county to county. Each county is a separate appraisal district. In fact, to reflect differences that can exist between counties, each county appraiser is expected to make adjustments to measures used in the cost method, as necessary, to help ensure the computer system generates fair market values.

The measures, which are summarized below, must be applied uniformly to all properties **within** the county. Appendix C shows how these measures are used in a formula in CAMA to calculate property values.

- **County Cost Index**: This index essentially represents a county's average inflation in construction costs since CAMA was implemented in the late 1980's. Even at that time, the index varied across counties. The index adjusts the "base" cost rates entered at that time to reflect current building costs. County appraisers must conduct an annual study of local construction costs to create an index for commercial properties, and an index for all other properties combined (referred to as the "residential index" because homes make up the majority of the cost data used to create it).

- **Base Cost Rate**: This measure generally reflects the cost per square foot of building a variety of types of structures in the late 1980's, when the CAMA system was first implemented.

- **Economic or "Expected" Life**: This measure represents the number of years that a commercial property is expected to be used profitably, or that an agricultural structure contributes to the value of a property.

- **Depreciation Level**: This measure, in combination with a property's expected life, will determine the speed and degree to which a property will lose its value over time. It also determines the remaining value a property will continue to have past its expected life.

For the properties we reviewed, we noted that variations in these county-wide cost measures were responsible for large variations in values of similar properties across county lines. As described below, some of those variations in cost measures didn't appear to us to be justified.

Differences in cost indexes across counties seemed justified, but we had some concerns about their overall use. As *Figure I-4* shows, applying the 2004 cost index to an identical hypothetical convenience store in each county can result in very different valuations.

Figure I-4
Valuations of Commercial Structures Can Differ Across Counties Based Solely on Differences in Counties' Inflation Rates

County	2004 Commercial Cost Index (inflation rate to calculate *current* construction costs)	Appraised value for hypothetical convenience store with a base cost of $60,000, and all other factors identical
Riley	39%	$83,400
Greenwood	29%	$77,400
Ellis	26%	$75,600
Ellsworth	22%	$73,200
Washington	17%	$70,200
Chautauqua	17%	$70,200
Marshall	16%	$69,600
Russell	14%	$68,400

Source: LPA analysis of the effect of differences in the 2004 commercial cost index.

As the figure shows, the commercial cost index varied from 39% in Riley County to 14% in Russell County. In other words, if a particular type of building was assigned a cost of $50/square foot in CAMA in the late 1980's, the inflation-adjusted "replacement cost" for that building today would be $69.50/square foot in Riley County but only $57/square foot in Russell County.

Similarly, the 2004 residential cost index (which is applied to agricultural structures) ranged from 20% in Chautauqua County to 70% in Riley County.

There can be very legitimate reasons for different counties to have had different cost inflation over the years. In addition, during its compliance reviews, Division of Property Valuation staff review counties' analysis for establishing commercial and residential cost indexes. In the 2004 compliance reviews for the eight counties we looked at, the Division found no problems. Still, we have the following concerns about the cost index measure:

- Applying the residential cost index to determine the current replacement cost for agricultural structures may not be appropriate. As described above, the residential cost index reflects the inflation for construction costs of all properties other than commercial, but the construction cost of homes makes up the majority of data to compute this index.

  For example, Riley County had the highest residential cost index, 70%, reportedly because of its sustained housing growth. Although this inflation rate must be applied to all agricultural structures in the county, the appraiser told us he made a conscious effort to lower the value of agricultural structures such as pole sheds, because in his opinion most land in the county isn't bought for farming purposes anymore.

- Because base costs were established almost 20 years ago, they've become less accurate over time for determining replacement costs for any particular type of structure. Several urban counties that have had significant growth (e.g. Johnson and Douglas Counties) have re-computed base costs within the last 10 years to produce more accurate replacement costs. However, rural or low-growth counties may not have sufficient data or staff resources to re-base costs for all the construction types.

As described later in the question, the new computer system will remedy these issues.

Many of the variations across counties in base cost rates, expected life, and depreciation level for agricultural structures didn't make sense to us. When CAMA was first implemented each of these measures was uniform across the State, but the Division encouraged counties to modify them to better reflect local market conditions. *Figure I-5* shows how the measures varied for a hypothetical 20' x 30' pole shed across the eight counties we reviewed.

Figure I-5
Differences in Base Cost, Expected Life, and Depreciation
For a Hypothetical, Identical 20' x 30' Pole Shed

County	Base Cost Rate	Economic or "Expected" Life	Lowest Depreciation Percent (a)
Central Region			
Ellis	$4,766	30 years	13%
Ellsworth	$4,617	40 years	26%
Russell	$3,479	25 years	20%
Northeast Region			
Marshall	$4,766	15 years	10%
Riley	$4,479	15 years	10%
Washington	$3,096	20 years	10%
Southeast Region			
Chautauqua	$3,669	30 years	19%
Greenwood	$3,531	20 years	20%

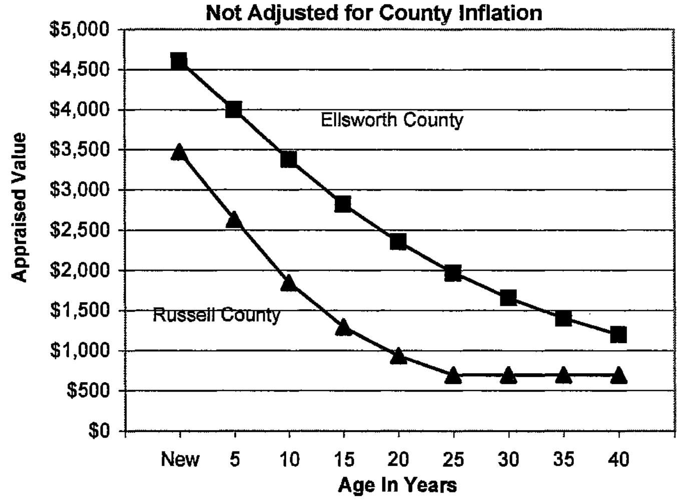
(a) Reflects the point at which a property will not further depreciate.

Source: LPA summary of 2004 cost and deprecation table information (which show economic life and depreciation, as well as rates to calculate base costs) from eight counties.

As *Figure I-5* shows, even neighboring counties had large variations. For example, our hypothetical 20' x 30' pole shed would have a difference in base cost of almost $1,700 depending on whether it was located in Marshall County or Washington County. In Russell County, the pole shed's expected life is 25 years, while in Ellsworth County it's expected to last 40 years. Lastly, in Ellis County the pole shed will depreciate down to 13% of its value, but in Ellsworth County it will only depreciate to 26% at the end of its expected life.

These measures all influence the appraisal value at various times during a structure's life span, as shown graphically in *Figure I-6* for our hypothetical pole shed in two counties.

Figure I-6
Value for a 20' x 30' Pole Shed
in Average Condition in Two Counties,
Not Adjusted for County Inflation



(a) To isolate the effect of varying base costs, expected life, and depreciation, we held the county inflation index constant.
Source: LPA analysis of the differences in the base cost, economic life, and depreciation tables received from county appraisers for a specific type of pole shed in average condition.

Because the variations shown in *Figure I-5* don't seem to make sense, we looked into how counties came up with the expected life they're currently using for pole barns. Here's what we found:

- Counties had no documentation to show why they'd adjusted expected life. Division of Property Valuation procedures require counties to retain the necessary documentation and statistical analyses when they adjust the base costs, expected life, and depreciation tables. In our discussions with three county appraisers, we learned that the measures were adjusted during the 1990's and no one still had any documentation that showed why and how the measures got changed. This makes it difficult for us—and for Division of Property Valuation staff—to determine whether the expected life being used is reasonable and justified.

- Division officials aren't certain that changes were reviewed or approved at the time they were made. Division staff told us their *current* practice is to perform a cursory review if they learn of changes in a county's expected life or depreciation tables, although the current compliance review form makes no mention of looking at changes in expected life. They don't know whether changes made in the 1990's would have been reviewed.

- Counties didn't follow any standard process for determining how expected life should be changed. The appraiser in Ellsworth County said they raised the expected life for a pole shed to 40 years because they determined (through review of agricultural sales and discussions with realtors) that pole sheds were holding their value longer than expected. In Riley County, on the other hand, the appraiser told us expected life for pole sheds was shortened in the early 1990's because he found most land isn't purchased for farming purposes anymore. Finally, the Russell County Appraiser told us that her predecessor had changed various factors including base cost rate, but had left no documentation for the changes. Because of that, when she took office, she changed all the rates back to the original numbers set by the Division.

Appraisers may be making similar undocumented adjustments to county-wide measures for commercial buildings. We found limited evidence to suggest there may be issues for commercial buildings as well. We noted that the 2004 compliance reviews for Chautauqua County and Russell County both indicated the counties didn't have depreciation analyses for certain types of commercial buildings, which means the depreciation levels they assigned couldn't be verified.

Many of the problems we found will be addressed by ORION, the new computer appraisal system, but the Division needs to ensure it has a process for overseeing adjustments appraisers may make over time. The complicated algorithm counties use and modify to calculate base costs for agricultural structures will be replaced by cost data from the Marshall & Swift appraisal company (known as the gold standard in real estate appraisal) when counties get the new computer appraisal system, ORION. Similarly, the new system will reflect current base costs for commercial structures.

Because counties will receive an annual update of the Marshall and Swift cost information, they won't need to calculate a cost index to reflect the inflation. In addition, the system will include depreciation tables and expected life spans that are uniform for all classes of properties—including agricultural structures—similar to what took place when CAMA was first implemented.

ORION will allow appraisers to override or modify some of this standardized data, if necessary to better reflect market conditions. Division officials said county appraisers would be expected to document and justify any modifications they make to the system data, just as they have been expected to do in the past.

To-date, however, the Division has not prepared guidelines for the types of analyses county appraisers should perform before making changes, nor has it adopted a standard procedure for monitoring the adjustments counties inevitably will make to the ORION system.

Conclusion

Kansas currently has about 1.5 million parcels of land covering more than 82,000 square miles; appraising those parcels in a uniform manner across the State is a significant challenge. Although taxpayers may question whether that challenge is being met successfully as they compare the county-appraised value of their property to that of a seemingly similar property, we found limited cause for concern. When we explored differences in value for pairs of commercial and agricultural structures within counties we identified systematic and logical reasons for those differences at a general level. Differences in values across counties raise more concern because many of the factors used in setting values (for example, the expected life of various types of structures) reflect the judgment of each county's chief appraiser. Many of those decisions were made long ago, and there is only anecdotal information about why certain choices were made. Appraiser judgment will always be a vital part of determining values, however with the implementation of ORION, a new computerized mass appraisal system, the State has a unique opportunity to ensure that when counties modify (as they will and should) elements in the system that affect all properties of a certain type, the rationale for those modifications is justified and documented.

Recommendations

1. To help ensure that commercial property valued using the income method is valued uniformly and at fair market value, the Division of Property Valuation should require county appraisers to document in a property's file the rationale for any deviations from market study data.

2. To help ensure that commercial property and agricultural structures valued using the cost method are valued uniformly and at fair market value, the Division of Property Valuation should:

   a. develop guidelines for counties on the types of analyses that must be done to justify adjustments in ORION's system data.
   b. continue its requirement for counties to make available documentation of any analyses that support a change in system data.
   c. modify the compliance review process to include review and approval by Division staff of changes to selected ORION system data that will be applied to all properties, before those changes take effect. This might include changes to the expected life of structures, base price, or other measures selected by the Division.

Question 2: Are Landowners Paying Lower Property Taxes on Land Held for Future Development Than They Should?

ANSWER IN BRIEF: *Land classified as agricultural receives a significant tax break. As a result, landowners who get vacant land reclassified as agricultural land do pay far less in taxes than they otherwise would. However, reclassification of land is allowed by law and has been upheld by the Kansas Board of Tax Appeals, district court, and the Kansas Court of Appeals. Appraisers in both Johnson County and Butler County have a process for determining whether land should be classified as agricultural, and were following their processes. Some states use a tax roll-back policy to recoup property taxes when agricultural land is reclassified. These and related findings are discussed in more detail in the sections that follow.*

Land Classified as Agricultural Receives a Significant Tax Break

The Kansas Constitution specifies that agricultural land is to be valued for tax purposes on its agricultural income or productivity (generally called "use" value), not on its fair market value. This results in a significant tax advantage. An example of a 625-acre tract of land we reviewed in Ellis County can help illustrate why:

Figure II-1
Effect of Classification on Assessed Value and Taxes

Assessed value and taxes for a 625-acre tract of land if it is valued as....

	...Agricultural land	...Other urban or rural land	...Vacant land
Appraised value	$30,000 (based on use value)	$177,000 (fair market value)	$177,000 (fair market value)
Assessment rate (from Kansas Constitution)	30%	30%	12%
Assessed value (appraised value X assessment rate)	$9,000	$53,100	$21,240
Tax (assumes a tax levy of 100 mills. Each mill = $1 in tax for every $1,000 in assessed value)	$900	$5,310	$2,124

Source: LPA analysis of data received from Ellis County.

Landowners Who Get Vacant Land Reclassified as Agricultural Pay Considerably Less in Taxes

In a 1993 audit, we noted that a 67-acre tract of vacant land in Leawood was appraised at an agricultural use value of $8,600 because a crop had been planted on it. If the land had been classified as a vacant lot, the appraised value would have been the fair market value —$5.8 million.

For this audit, legislators raised a similar concern; namely, that landowners are getting land reclassified from vacant land to agricultural land so they can pay lower taxes until the property is developed. To determine the extent to which that is happening, we looked into reclassifications of land parcels in two growth counties—Johnson and Butler.

For tax year 2004, 64 parcels of land were reclassified from vacant to agricultural land in Johnson and Butler Counties. While we couldn't determine whether these parcels were all located in commercial settings, our review showed:

- In Johnson County, 44 parcels were reclassified from vacant to agricultural land, ranging from a 3,466-square-foot parcel to a 43-acre tract. Almost half these parcels had street addresses that indicated they were located in a commercial or residential setting. One example: a 1.6-acre vacant parcel near the intersection of Metcalf and West 146th Street in Overland Park that was appraised at almost $440,000 in 2003 dropped to $120 in value after being reclassified as agricultural land in 2004. The property tax dropped from $6,000 to $412.
- In Butler County, 20 parcels were reclassified to agricultural use for the 2004 tax year. They ranged in size from less than one-half acre to 63.4 acres.

Figure II-2
Tax Effect of Reclassifying Vacant Land to Agricultural Land
Johnson and Butler Counties

	Classified as Vacant Land 2003 (a)	Reclassified as Agricultural Land 2004 (a)	Difference (a)
Appraised Value	$17,058,000	$53,700	($17,004,300)
Assessed Value	$1,787,000	$11,600	($1,775,400)
Tax Amount	$259,000	$54,600 (b)	($204,400)

Source: LPA analysis of county data
(a) Amounts reflect 34 parcels in Johnson County because 10 parcels were excluded because only part of the parcel had been reclassified.
(b) Tax amount is greater than the appraised value because it includes special assessments.

Figure II-2 shows that these reclassifications lowered appraised values of land by at least $17 million, and reduced property taxes by at least $204,000.

Getting vacant land reclassified as agricultural land is relatively easy, because the State's definition of agriculture is so broad. Land qualifies for the agricultural classification, regardless of whether it's within city limits, as long as it's devoted to the production of plants, animals, or horticultural products. The statute includes in this definition the growth of forages, grains and feed crops, dairy animals and dairy products, poultry and poultry products, beef cattle, sheep, swine and horses, bees and apiary products, trees and forest products, fruits, nuts and berries, vegetables, and nursery, floral, ornamental and greenhouse products.

Based on the Kansas Court of Appeals 1989 ruling, it's clear that an activity doesn't have to look like "traditional agriculture" to qualify land for agricultural use classification. In arriving at that ruling in Board of County Commissioners of Johnson County v Smith, the Court cited the following rationale:

- there is no statutory minimum acreage requirement for agricultural land
- there is no statutory requirement that a profit be made from the land
- intention of future use of the property isn't relevant when classifying land

- there is no law prohibiting a developer from buying land and using it for agriculture until it's developed
- there is no law prohibiting a landowner from planting hay to obtain a more favorable classification
- the statutory test of agriculture use is whether the specific piece of land is used for agriculture, regardless of what the surrounding property is used for

Since 1989, decisions by the State Board of Tax Appeals generally have been consistent with the court's ruling.

County appraisers followed all requirements in handling these reclassifications. The Division of Property Valuation guidelines state the county appraiser is to determine proper classification after reviewing each property. To support requests for getting land reclassified as agricultural, in Johnson and Butler Counties, owners are required to submit documentation such as a lease agreement for farm services, copies of farm expenditures, a federal tax return for farming operations, or pictures of ongoing farming operations (such as hay bales on the land or tractors spreading seed). In addition, the appraisers may visit the site to try to confirm that reclassification is warranted.

Our review of the files for nine properties that were reclassified (five in Johnson County and four in Butler County) showed that all contained the type of documentation the appraiser required to justify reclassification to agricultural. While in Johnson County, we learned that one individual had entered into an agreement with four of the five property owners; the appraiser also told us this individual often helps landowners achieve and document the agricultural use classification by offering his services.

County appraisers told us that the burden is on them to ensure land is classified correctly. To decide whether agricultural classification is warranted, appraisers in Johnson and Butler Counties said they review such things as aerial photographs, conduct visual inspections, and check for building permits to look for indications that the land is no longer being used for agriculture.

Some of the parcels reclassified from vacant to agricultural looked questionable to us. We visited six of the nine parcels for which we had reviewed the paper files — three in Johnson County and three in Butler County. As noted earlier, all nine parcels had documentation on file to justify an agricultural classification.

All three parcels in Butler County appeared to have brome or native grasses growing on them, as did one of the Johnson County parcels.

However, two of the parcels in Johnson County (shown below) seemed questionable to us, in spite of the fact that both had lease agreements in their files indicating someone had been retained to "overseed" the land.

Some Johnson County Properties Classified As Agricultural Land Appeared To Us To Be Just Plain Vacant Lots

Our sample of properties turned up these examples of land that didn't appear to be used for agricultural purposes.

The Johnson County Appraiser told us that because of the existing lease agreements on file for the parcels we questioned, he thought the Board of Tax Appeals would support the reclassification to agricultural land, given its previous rulings. In regard to the parcel with no growth, he noted there's no requirement for land owners to be prudent farmers; they can spread seed on the last day of the year, or claim crop failure to explain why no growth was occurring on the land.

County Appraisers May Use the Developer Discount When Determining Fair Market Value

In a 1993 audit, we noted that county appraisers were giving a discount to real estate developers who owned vacant parcels, but didn't give the same discount to individuals owning similar property. The developers' discount influences the value of vacant lots still owned by developers by a certain percentage. For example, applying a 30% discount would result in a $10,000 lot to have a fair market value of $7,000. In the 1993 audit, we pointed out that Division of Property Valuation directives allowed the discount after finding that it was commonly used, even though it wasn't specifically authorized by Kansas law.

A Kansas Supreme Court case, Hixon v. Lario Enterprises, Inc. (1995), determined that the developer's discount methodology violated the statutory scheme for determining the fair market value of property. In response to the Court's decision, the Kansas Legislature amended State law to allow county appraisers to also consider additional costs developers may incur in getting the land ready for development in determining fair market value.

During this audit, we learned that the developer discount isn't being used by all county appraisers. Some appraisers said they don't use it because there is little development activity in their county. Butler County doesn't use the discount because it thinks it violates the fair market value standard. In Johnson County, which has decided to allow the discount, an individual who owns at least three lots in a subdivision will receive the discount based on the absorption or sell-out period of the remaining lots automatically. The discount, currently about 30%, is calculated every year and is based on the length of time it takes for the parcels to sell.

Some States Use a Tax Roll-Back Policy To Recoup Property Taxes When Agricultural Land Is Reclassified

The tax break that can result from the agricultural use classification has caused concerns in Kansas ever since it was instituted in the late 1980's. As we recommended in our 1993 audit, one option is to recoup back taxes when land changes from agricultural use to a commercial or residential classification.

Both Nebraska and Texas have tax roll-back policies for agricultural land that changes status. Agricultural land in Nebraska is valued at 80% of its fair market value. If the land changes to commercial use, the roll-back policy allows the state to recoup the remaining 20% of tax for the current and past three years on the property as if it had been appraised at full fair market value throughout that time.

Texas also has a tax roll-back policy, charging the difference between taxes paid on the land's agricultural value and the taxes that would have been paid if the land had been taxed on its higher market value for the past five years. In addition to paying these net taxes, the owner pays an additional 7% interest. Colorado, Missouri, and Oklahoma don't have tax roll-back policies.

The Kansas Constitution allows the Legislature to institute a tax roll-back policy. Article 11 states, "If land devoted to agricultural use changes from such use, the legislature may provide for the recoupment of a part or all of the difference between the amount of taxes levied on such land ... and the amount of taxes which would have been levied on that land if it hadn't been in agricultural use."

County appraisers said that developers may still reclassify land temporarily in order to defer these additional taxes, but the advantages of a tax policy include that those taxes would be recoverable, and it would lead to additional revenues for the taxing bodies.

County appraisers also cited disadvantages of a tax roll-back policy. These included the additional administrative cost and time for appraisers as well as treasurers to be able to research and bill any applicable back taxes, as well as a potential negative effect on development activity because of the additional costs developers could incur.

Options also exist for preventing landowners from being able to reclassify vacant land temporarily to reduce their tax obligations. We talked with Division of Property Valuation staff and county appraisers about the advantages and disadvantages of policies that would prevent the type of reclassification that is currently occurring. The points they made are summarized in *Figure II-3* on the next page. Generally, they identified significantly more disadvantages related to trying to prevent reclassifications than to instituting a tax roll-back policy.

Conclusions and Recommendations can be found at the end of Question 3.

Figure II-3
Options for Restricting the Agricultural Use Classification, And Opinions About Potential Advantages and Drawbacks

Option	How It Would Work	Points To Consider/Potential Drawbacks
Implement a "highest and best use" concept for agricultural property	This requires that each property be appraised at its most profitable use that is physically possible, legally permissible, financially feasible, and most productive. In doing so, all land (including land used for agricultural purposes) would be appraised at its "fair market value." This option would prevent developers from lowering their property taxes because vacant land located in desirable neighborhoods would have a market value reflective of its potential and be appraised as such.	• Would require a change to the Constitution in order to eliminate the agricultural use classification • May require revision to the statute defining "fair market value" to ensure properties are valued based on the four-pronged test for highest and best use (physically possible, legally permissible, financially feasible, and most productive). • Could squeeze farmers out of business because farming operations may not be able to support the resulting higher property taxes. In addition, implementing this concept could affect appraisal values of other properties such as a lone house with a commercial district developing around it. • Would require administrative changes and re-tooling of the mass appraisal computer system, as well as re-training at the State and local levels. • Could be seen as a policy not supportive of Kansas farmers.
Prohibit reclassification to agricultural use when zoning regulations don't support that use	Vacant land that's located in areas zoned to support commercial, residential, or industrial development could not receive the agricultural use classification. Land already classified as agricultural would keep its classification if the land is forcibly zoned (i.e. the city grows). In Maryland, if a rezoning occurs at the initiative of the county, the land retains the agricultural use assessment. In Oregon, there is an exclusive agricultural use zoning that prevents agricultural use in areas zoned as something else.	• Would require a change to the Constitution in order to restrict the agricultural use classification. • Requires county appraisers to take notice of zoning regulations and the type of re-zoning occurring in relation to properties in question. • Only about half the counties in Kansas, and not all cities, have zoning regulations
Institute a waiting period and require the property owner to submit documentation before land is reclassified to agricultural use	A property owner requesting reclassification to agricultural use would need to prove that the land had been used for agricultural purposes for a specified period of time by submitting documentation (e.g. federal farming income/loss statements). This would not affect land already classified as agricultural use. Alabama, Arizona, Connecticut, Louisiana, Michigan, Nebraska, Utah and West Virginia require property owners to apply for the agricultural use classification.	• Would require revisions in the statute that defines agricultural use to require the proof of documentation and allowing the waiting period before land can receive agricultural use classification, while grandfathering in land that's already classified as agricultural use. • Instituting a "waiting period" may be legally challengeable because the Constitution states that all land used for agricultural purposes should receive agricultural classification. • Would increase the administrative burden and cost at the local level because of the additional time and resources to review and track documentation.

Source: International Association of Assessing Officers "Technical Assistance Project- Agriculture Use Value Study", and LPA interviews with Division of Property Valuation staff and county appraisers.

Question 3: Is Agricultural Land That Has Been Purchased Primarily for Recreational Purposes Being Classified Correctly?

ANSWER IN BRIEF:	*Non-residents have purchased many large tracts of agricultural land in southeast Kansas in recent years–some of which undoubtedly are being used for recreational purposes, but because the agricultural use definition is very broad, it's difficult to prove that land is not devoted primarily to agriculture and is instead being used for recreational purposes. County appraisers followed their processes for determining the correct use of the land, given the constraints of proving land is devoted to something other than farming. These and related findings are discussed in more detail in the sections that follow.*

Land Used for Recreational Purposes Is Specifically Excluded from the Definition of Agricultural Land

Legislators have raised questions about whether agricultural land that's been purchased (often by people who come from outside the county) is being classified properly if it was purchased primarily for hunting or other recreational purposes.

State law specifically excludes land used for recreational purposes from the definition of agricultural land. Under the Kansas Constitution, recreational land falls under the classification of "other urban and rural" property, and is assessed at 30% of its fair market value. This results in significantly higher taxes than if the land were classified as agricultural and assessed at 30% of its use value.

To determine the extent to which land may be being purchased primarily for recreational purposes, and how that land is being classified, we interviewed appraisers in six counties that are considered to be good hunting country, and reviewed actions they had taken to consider or change classifications.

Non-Residents Have Purchased Many Large Tracts of Agricultural Land in Southeast Kansas in Recent Years

We reviewed three counties in central Kansas (Ellis, Russell, and Ellsworth) and three counties in southeast Kansas (Greenwood, Chautauqua, and Elk).

Few large tracts of land were purchased by non-residents in central Kansas, and county appraisers didn't think there was significant use of the land for recreational purposes. Appraisers in Ellis, Russell, and Ellsworth Counties queried their computer systems to determine how many large tracts (more than 250 acres) of agricultural land were sold to non-residents in 2003 and 2004 (through November). Only 10 such parcels were found across all three counties during the two-year time period.

None of the appraisers expressed concern that this land was being bought and used primarily for recreational purposes. Although they indicated farmers increasingly are renting their land to hunters for a limited number of days during hunting seasons, in the appraisers' opinions, farming was still the primary use of the land.

Many non-residents purchased agricultural land in southeast Kansas, and appraisers in this region expressed a higher level of concern about such land primarily being used for recreational purposes. Computer queries by appraisers in Chautauqua and Greenwood Counties identified 48 large parcels of land that had been sold to non-residents in 2003 and 2004 (through November). The Elk County appraiser was unable to run a query, but volunteered anecdotal information. *Figure III-1* summarizes information about these non-resident sales.

Figure III-1
Large Tracts of Agricultural Land Sold to Non-Residents
2003-2004

County	Number of Parcels Sold (>250 acres)	Total Number of Acres Involved in Those Sales
Chautauqua	24	10,153
Greenwood	24	13,803
Elk	Details not available, but appraiser indicated a "great deal of land" is being purchased by non-residents in 40- to 80-acre plots	

Sources: Chautauqua, Greenwood, and Elk County appraisers, and data provided by those appraisers.

The Elk County appraiser told us that agricultural land being purchased for recreational purposes was one of the biggest problems he faced. The Chautauqua County appraiser expressed some concerns about agricultural land being used primarily for recreational purposes. The Greenwood County appraiser expressed no concerns that land was being bought for recreational use but getting the agricultural use classification.

None of the Properties We Reviewed In Southeast Kansas Had Been Reclassified To Reflect a Change in Their Use Status

County appraisers are required to review aerial photographs, conduct field inspections, or use questionnaires to determine whether agricultural lands are classified correctly. Five of the six counties we reviewed had adopted a process for determining whether land was classified correctly, although none of those processes would definitively identify recreational use. The Elk County appraiser told us he's not doing anything to verify that land is truly used for agricultural purposes because "it's an effort in futility if all he does is fight these cases and loses them."

We reviewed the files of 11 properties in the remaining five counties to determine whether county appraisers followed their processes and we saw documentation that indicated aerial photographs were taken, field inspections were done, or agricultural use questionnaires were completed for all 11 properties.

Appraisers cited several reasons why it's difficult to reclassify land even if they think it's being used for recreation. They include the following:

- **Even though the land may have been purchased to provide a place for hunting or other recreational use, most of the time it is primarily used for agricultural purposes.** Often the land is leased to farmers or large companies for grazing cattle, producing hay, or other agricultural uses. In such cases, the land may still be used much of the year for agricultural purposes. The Elk County appraiser told us of some cases where new owners want cattle removed from the land entirely, but even so, he didn't think that would constitute sufficient evidence to justify reclassifying the land.

- **It is difficult to justify a reclassification because there's no real definition of what qualifies as land "devoted to" agriculture.** That's the phrase used in the Kansas Constitution – "land devoted to agricultural use is to be assessed on its "use value," not its fair market value. The Division of Property Valuation has interpreted "devoted to" as meaning the primary use of the land. Its training materials for county appraisers state that the "primary" function of the land should determine its use, and use is based on the appraiser's judgment.

  In Chautauqua County, the appraiser indicated that, for some properties, cattle are not on all land year-round. In fact, cattle may be there for as little as three months out of the year. Given the broad definition of agricultural land, and the effort and money involved to challenge the classification of land through the State Board of Tax Appeals, she says it's not worth her time to change the classification.

- **Some appraisers think it's not worth the effort to reclassify land that is only marginally used for agriculture, because landowners could rightfully claim agricultural use the next year by making only limited changes.** Following the Kansas Court of Appeals ruling in the Smith case (page 21), the State Board of Tax Appeals has tended to agree with landowners that land qualifies for agricultural classification even if there's only limited evidence of agricultural production. For example, the Board ruled in favor of a property owner in Johnson County who had two parcels of land, because the owner had submitted pictures to prove timber had been cut and sold from the trees growing on the land.

Even though the law specifically excludes land used for recreational purposes from land classified as agricultural use, the issue is that these uses are not mutually exclusive. If the Legislature wants to address this issue, it would need to clarify how the two uses should be separated by adding or tightening up the law.

Conclusion

The State's broad definition of agricultural use continues to cause concern. Based on the Court of Appeals' interpretation of the statute, landowners have been able to qualify for significant tax breaks that may not have been intended when the statute defining agricultural use was passed. A relatively new concern deals with land used for recreational purposes. While State law specifically excludes land used for recreation from the agricultural use classification, these uses aren't mutually exclusive, and land on which both uses are occurring will normally be classified as agricultural. Solutions to these issues would require major and controversial changes in Kansas' property valuation system, but ultimately, the Legislature will have to grapple with whether it wants to provide tax advantages for landowners who are not maximizing the agricultural use of land.

Recommendations

To address the problems resulting from the broad definition of agricultural use in Kansas law, the House and Senate Agriculture Committees and the House Taxation and Senate Assessment and Taxation Committees should:

a) receive testimony on the feasibility and desirability of instituting a tax roll-back, or any of the other options listed on page 25, when agricultural land changes classification.

b) consider amending State law to provide a definition for recreational use.

c) consider amending State law to delineate the point at which land is considered to be used for recreational or agricultural purposes.

APPENDIX A
Scope Statement

This audit was approved by the Legislative Post Audit Committee on October 11, 2004. The requesting legislator was Representative Sharon Schwartz.

Property Valuation in Kansas: Reviewing the Valuation of Agricultural and Commercial Properties

State law requires all real property subject to taxation to be appraised uniformly and equally as to class, and at its fair market value (except agricultural land, which is valued at "use" value.) At the State level, the Division of Property Valuation in the Kansas Department of Revenue is responsible for overseeing the valuation of properties for tax purposes to ensure they are uniform and equal under the law. At the local level, county appraisers, appointed by local boards of county commissioners, are responsible for carrying out appraisal work.

Recently legislators have heard concerns from constituents about significant variations in values for farmland, farm-related property, and commercial property. They cite examples such as some counties placing a high value on harvest store silos and other counties placing little or no value on them. Also, some owners of commercial property have expressed concerns about the level of property tax they pay in relation to what owners of similar property pay in other counties. In addition, legislators have expressed concerns about property being valued at agricultural use when it is being used for recreational purposes. Legislators want to know whether uniform standards are being promulgated and enforced by the Division of Property Valuation as they relate to farm and commercial properties.

A performance audit of this topic would answer the following question:

1. Are county appraisers in Kansas valuing farm and commercial properties according to the law and guidelines established by the Division of Property Valuation? To answer this question, we would review State law and directives from the Division of Property Valuation related to valuing farm and commercial properties. Also, we would look at what types of reviews the Division of Property Valuation has done to ensure that counties are accurately valuing farm and commercial properties. We would select a sample of counties around the State and interview the county appraisers and review relevant records to determine how they go about appraising farm and commercial properties in their counties. We would review recent appeals to the Board of Tax Appeals from each of those counties to determine what types of issues are arising and how often the appraisers values are being overturned by the Board. We would then select a sample of farm and commercial properties in each of our sample counties and review the appraisals to determine whether the generally met the requirements of law and the guidelines issued by the Division of Property Valuation. We would pay particular attention to whether large parcels owned by non-resident landowners that are given agricultural use value are actually meeting the requirements for receiving that type of value. Finally, we would follow-up on the findings from our 2002 audit of commercial property valuations to determine what valuation changes occurred as a result of that audit.

Estimated time to complete: 12-14 weeks

APPENDIX B

Comparisons of Commercial Properties Within Counties

This appendix provides the results of 14 comparisons of commercial properties in 8 counties. We selected pairs of properties for which:

- values were different, but the properties seemed relatively similar
- values were similar, but the properties seemed different
- values went the opposite direction of what we would have expected

In some cases, our comparisons looked only at the value of the primary structure, while in other cases we looked at the entire property. Our comparisons on the next pages are grouped as follows to reflect these decisions:

- for properties appraised using the cost method, we compared the value of the primary buildings
- for properties appraised using the income method, we compared the value of the entire properties (the income method doesn't separate out a value for the primary building)
- for pairs in which one property was valued using the cost method, and the other was valued using the income method, we compared the entire properties

Appendix B
Comparison of Commercial Properties Within Counties

Property Name	City	Year Built	Grade	Building Value / Sq. Ft.	Factors That Contribute to the Difference in Value
Properties valued using the cost method: Because this method computes separate appraisal values for the building, improvements (eg. canopies, pavement, lighting), and land, we compared only the primary building values					
Self Stor Downtown	Hays	2003	D	$19.21	Infrastructure quality, Grade and Location. Self Stor has more overhead doors, which increases its base value per square foot, and is a higher grade of construction. In addition, J&E Storage is located in a neighborhood that has low demand for mini-storages.
J&E Storage	Victoria	2001	D-	$10.75	
Miniwarehouses	Hays	2002	D-	$15.88	Location. J&E Storage is located in a neighborhood that has low demand for mini-storages.
J&E Storage	Victoria	2001	D-	$10.75	
Casey's #1	Hays	2000	B-	$50.34	Infrastructure quality, Age and Grade. Casey's #1 has a higher base value per square foot because it's a brick building, while Total is metal. In addition, Total is 11 years older so it has depreciated further, and is a lower grade of construction. Both factors work to lower the its value.
Total	Hays	1989	C	$29.41	
Casey's #2	Hays	1997	B-	$44.88	Infrastructure quality, Age and Grade. Casey's #2 has a higher base value per square foot because it's a brick building, while Total is metal. In addition, Total is 8 years older so it has depreciated further, and is a lower grade of construction.
Total	Hays	1989	C	$29.41	
Tower Wholesale & Leasing	Russell	1999 to 2002	C/D	$16.24	Infrastructure quality, Age and Grade. Tower Wholesale & Leasing has a higher base value per square foot because of materials (fire resistant vs. pre-fabricated steel). The unnamed mini-storage is somewhat older and is a lower grade of construction.
Unnamed mini-storage	Russell	1998	E+	$7.21	
Amoco Service Station	Russell	1992 & 2000	C	$40.31	Infrastructure quality and Age. Amoco has a higher base value per square foot because it's made of concrete while Casey's is metal. Casey's also has more depreciation.
Casey's	Russell	1996	B	$32.96	
Shop Quik Texaco	Manhattan	1988	B-	$52.46	Infrastructure quality and Grade. Even though Shop Quik Texaco is nine years older, it has a higher base value per square foot than Casey's because its walls are taller and it is a slightly better grade of construction.
Casey's	Ogden	1997	C+	$45.03	
Betty's Food & Fuel	Home City	1960	D+	$11.34	Age. Betty's Food and Fuel has depreciated only 45%, compared to Plegge Oil, which has depreciated 80%. This is not only a result of the 8-year age difference, but also because Plegge Oil had inferior physical and functional characteristics, which influence depreciation.
Plegge Oil	Home City	1952	D+	$7.19	

Source: LPA analysis of inventory sheets of sample properties provided by county appraisers.

Appendix B (continued) Comparison of Commercial Properties Within Counties					
Property Name	**City**	**Year Built**	**Grade**	**Property Value / Sq. Ft.**	**Factors That Contribute to the Difference in Value**
Properties values using the income method. Because this method doesn't separate appraisal values for the building, improvements, and land, we compared the values of entire properties.					
U-Rent Storage	Eureka	1988	C	$13.65	Location. The appraiser adjusted rental and expense rates at U-Rent Storage (resulting in a higher net rental rate) based on information from previous appeal hearings and knowledge of what some people were paying to lease space at U-Rent.
Williams Storage Units	Eureka	1988	C	$11.26	
Johnson's General Store	Eureka	1970	C	$46.01	Location. Even though Johnson's General Store is 18 years older and is a slightly lower grade of construction, these factors play only a minimal role when using the income method. Johnson's has a higher rental rental rate than Casey's because it's located in a more desirable part of town.
Casey's	Eureka	1988	C+	$44.85	
Properties valued using different methods: Because the two valuation methods are based on different variables, we couldn't make direct comparisons. However, the properties that were valued using the income method also had been valued by the cost method (even though that wasn't the value the appraiser used), so we reviewed the cost values as a surrogate in making our comparisons.					
Panzer's Mini Storage	Ellsworth	2000	D+	$16.84 - Income $19.43 - Cost (not used)	Age, Grade, Improvement, and Land Value: Panzer's Mini Storage is newer and is a slightly better grade of construction. It also has a detached garage, and its land is slightly higher-priced than Ranker Rental's land.
Ranker Rentals	Ellsworth	1986 & 1987	D-	$7.50 - Cost	
Ampride	Ellsworth	1985	C	$53.33 - Cost	Improvement and Land Value: While the building value was nearly identical for these properties, Ampride has nearly twice as much land as Food Mart, and proportionally more improvements for its size.
FoodMart	Ellsworth	1986	C	$36.70 - Income $36.06 - Cost (not used)	
Kleppers Korner Store	Manhattan	1987	C	$83.17 - Income $82.09 - Cost (not used)	Improvement Values: The value of Klepper's building is less than that of Shop Quik Texaco and Casey's, which is caused by the differences in age and construction grade. However, Kleppers has far more value in improvements (a huge canopy and paving) than the other two properties.
Casey's	Odgen	1997	C+	$71.03 - Cost	
Shop Quik Texaco	Manhattan	1988	B-	$69.82 - Cost	
Source: LPA analysis of inventory sheets of sample properties provided by county appraisers.					

APPENDIX C
Examples of the Cost Method Calculation for Commercial and Agricultural Properties

Some commercial properties and all agricultural structures are appraised using the cost method. This method takes into consideration a number of factors, which are explained below.

- Unadjusted Replacement Cost New: A starting value that reflects the base cost per square foot for each type of property, multiplied by size of the structure. Base costs were established in the late 1980s.
- Expected life: The time during which a property can be expected to be used profitably. For agricultural structures, it reflects the time during which a particular structure will contribute value to the entire property.
- Age: How old the building is.
- Percent Good: This is the opposite of depreciation and reflects the remaining value of the property. It's based on a property's condition, age, and expected life.
- Grade: A measure of the quality of materials and workmanship, expressed in letters typically ranging from A to E. In calculating value, grade is represented as a number ranging from .4 to 2.5 . The average grade is C, with a numeric value of 1.
- Economic factor: An indicator of the economic state of the neighborhood where the property is located, including the appropriateness and demand for this type of property in this neighborhood.
- County index: A county-specific inflation factor used to bring the late-1980's costs built into CAMA up to current costs.
- Land value: The value of the land on which the building sits is calculated by CAMA based on land pricing models that counties update with current market data.
- Improvement values: Values for additional features of the property such as paved parking, lighting, etc.

These tables illustrate how these factors are used to calculate an appraised value for a commercial building and an agricultural structure.

Cost Method Calculation of Appraised Value for a Commercial Property

Factors	Sample Property
Unadjusted Replacement Cost New (URCN)	$100,000
x Percent Good	60%
Unadjusted Replacement Cost New Less Depreciation (URCNLD)	$60,000
x Grade	1.0
Adjusted RCNLD	$60,000
x Economic Factor	.95
Adjusted RCNLD	$57,000
x County index	1.22
Final appraised building value	$69,540
+ Land value	100,000
+ Improvement Value	$5,000
Final Appraised Property Value	**$174,540**

Cost Method Calculation of Appraised Value for an Agricultural Structure

Factors	Sample Structure
Unadjusted Replacement Cost New (URCN)	$10,000
x Grade	.78
Adjusted RCN	$7,800
x Percent Good	35%
Adjusted Replacement Cost New Less Depreciation (RCNLD)	$2,730
x County Index	1.14
Final Appraised Value	**$3,112**

APPENDIX D
Update on our 2002 Audit on Commercial Office Buildings That Didn't Appear To Reflect Their Fair Market Values

As part of this audit, we were asked to follow up on an audit we issued in November 2002. In 2002, Legislative Post Audit conducted an audit that examined whether county appraisers were accurately valuing commercial office properties in selected Kansas counties. Of the 32 commercial office buildings we reviewed in that audit, nine buildings didn't appear to be accurately valued: seven appeared to be undervalued, and two appeared to be overvalued.

To follow up on the appraisal values for these nine buildings, we looked at their 2003 and 2004 property valuations, as well as at information regarding appeals. The appraised values for four of the seven undervalued properties had been increased, but pending decisions by the Board of Tax Appeals may change those values. This information is shown in this appendix.

Appendix D
Comparison of Appraised Values Before and After 2002 LPA Audit (in millions)

Name of Property	2002 Appraisal Value	Value LPA Computed Based on Market Study Data	2003 Appraisal Value	2004 Appraisal Value	% Change of Appraisal Values 2002-2004	Was there an Appeal?
Undervalued properties						
Bank of America (Topeka)	$5.8	$14.9	$12.1	$13.2	Increased 128%	Appealed the 2004 value; decision pending
Townsite Plaza (Topeka)	$5.5	$7.7	$7.6	$9.1	Increased 65.5%	Appealed the 2004 value; decision pending
Epic Center (Wichita)	$14	$23.2	$19.2	$19.2	Increased by 37.1%	Appealed the 2003 value; decision pending
Brotherhood Bldg. (Kansas City)	$2.5	$5.3	$3.1	$3.1	Increased by 24%	No
Mills Bldg. (Topeka)	$2.5	$4.8	$2.5	$2.5	No change	No
US Bank (Topeka)	$5.4	$6.8	$5.4	$5.4	No change	No
Capital Towers (Topeka)	$9.2	$9.3	$8.5	$8.5	Decreased by 7.6%	Appealed the 2003 value, which resulted in drop to below the 2002 value.
Overvalued properties						
New England Bldg. (Topeka)	$5.0	$3.6	$5.3	$4.8	Decreased by 4%	Appealed the 2003 and 2004 values; decisions pending
Southcreek Bldg. (Overland Park)	$5.5	$4.1	$5.5	$5.3	Decreased by 3.6%	Appealed the 2003 and 2004 values; decisions pending

Source: LPA audit 11-02; LPA review of Johnson, Sedgwick, Shawnee, and Wyandotte County appraiser websites and Board of Tax Appeals information.

APPENDIX E

On February 21, we provided copies of the draft audit report to the Department of Revenue and to the 10 county appraisers. We received a response from the Department and from Marshall County. Their responses are included as this Appendix.

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JOAN WAGNON, SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

March 3, 2005

Ms. Barbara Hinton,
Legislative Post Auditor
Legislative Division of Post Audit
800 SW Jackson, Suite 1300
Topeka, Kansas 66612

Dear Ms. Hinton:

Thank you for the opportunity to respond to the draft audit report, *Property Valuation in Kansas: Reviewing the Valuation of Agricultural and Commercial Properties*

As you have noted in the audit report, nearly all Kansas counties are in compliance with State appraisal guidelines. In essence, this says that county appraisers are doing a quality job of valuing all classes of property -- commercial, residential, and agricultural. Our role is to monitor their efforts to ensure equity and consistency, and to support continual improvement. We look forward to providing new and improved tools for the county appraiser, an example being the new ORION computer assisted mass appraisal system, scheduled for implementation over the next several years.

Your write-up in Questions 2 and 3 regarding the valuation of land classified as agricultural, provides an informative and accurate view of the tax impact of the agriculture use classification. We concur with your finding that county appraisers are following the applicable laws and guidelines for the classification of such properties. Should the legislature elect to consider amending state law governing classification, we will be happy to provide information on the tax consequences and changes in appraisal procedures that may be called for in light of proposed statutory changes.

Here are our responses to the recommendations in Question 1 addressed specifically to the Department of Revenue:

1. The Division of Property Valuation has increased the requirements for documentation detail and incorporated these requirements into our compliance inspections in the past few years. We recognize the value of county appraisers retaining supporting documentation for subsequent review when they have deviated from a model based estimate to compute, in their judgment, a more accurate appraised value. We will review our documentation standards and make appropriate changes where warranted.

DOCKING STATE OFFICE BUILDING, 915 SW HARRISON ST., TOPEKA, KS 66612-1588
Voice 785-296-3042 Fax 785-368-8392 http://www.ksrevenue.org/

2a. The successful implementation of the ORION system calls for a number of procedural changes designed to make the best use possible of the improved capabilities of the computerized system. We are reviewing our existing guidelines and making changes where appropriate to help support county appraisers in this endeavor.

2b. As noted in our response to Recommendation 1, we are emphasizing the importance of appropriate documentation in our revised guidelines.

2c. Every year, we reconsider our compliance review process and make changes that we feel will improve its efficiency, effectiveness, and usefulness as a set of standards for county appraisers. This year, we must reconsider the steps in our compliance review in light of ORION implementation. While county appraisers will always need to make changes to reflect appropriate values arising from their appraisal judgment, a review of these data changes should be an integral part of our compliance work.

However, we do not agree that county appraisers should be required to seek and obtain PVD's approval prior to making changes they deem necessary. PVD is neither positioned nor staffed to render approval on a timely basis of changes made by county appraisers in 105 counties. We will continue to provide guidance, advice, and compliance review to help appraisers sustain high standards of appraisal quality.

Sincerely,

Joan Wagnon

Joan Wagnon,
Secretary

Marshall County Appraiser

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February 22, 2005

Kristin Osterhaus
Legislavtive Division of Post Audit
800 Southwest Jackson St., Ste 1200
Topeka, KS 66612-2212

Dear Ms. Osterhaus:

I received a draft copy of the perfomance audit. The letter was addressed to the Washington Co. Appraiser, but I assume the text of the letter would be the same for all counties involved.

I read with interest the findings as well as the recommendations. I have no comments or corrections on this draft.

Sincerely,

Janet Duever

Janet Duever
Marshall County Appraiser

MARSHALL COUNTY