A Shrinking Tax Base … and its Impact on Our Residents

By Chardae Caine, Research Associate, League of Kansas Municipalities

Within the past decade, the "dark store theory" was coined to describe certain appeals of property valuations by commercial owners. The League is utilizing the term Alternative Property Valuation instead of "dark store theory." Several cities and counties are recognizing the impact of alternative property valuation but, in most cases, the disputes over structures' highest and best uses have not been noticed by those that matter most, our citizens.

There are three methods to valuing property. The sales comparison approach requires appraisers to maintain comparable properties sold in the surrounding area as a tool in the assessment process. The cost approach determines the price an owner has paid for the land and any construction that has taken place since the property was last appraised and subtracts a cost for depreciation of the property. The income approach is used when a property generates income for the owner and that revenue is used to help identify the market value of the property.

Alternative Property Tax Valuation occurs when a business appeals its county-appraised valuation and offers an alternative valuation for their property which is substantially lower. The alternative property valuation submitted often includes properties that do not have the same "highest and best use" as the owner's property and therefore are not comparable properties for assessment purposes. Through this form of valuing property, the assessed valuation is challenged and, therefore, the property taxes associated with the physical location of a business may be modified.

When all approaches are examined, a fair assessment is determined. However, when one only approach is used to determine the assessed valuation, the limited methodology diminishes the fair market value for Kansas properties, and can eventually lead to the deterioration of Kansas communities. Article 11, Section 1 of the Kansas Constitution states "the legislature shall provide for a uniform and equal basis of valuation and rate of taxation of all property subject to taxation." Naturally, that is open for interpretation and with the rise of alternative property valuation requests across the state, we now have at least two contradicting perceptions of the law.

An Unfair Tax Burden

Lowering property taxes for commercial properties impacts residential property owners. By changing the valuation approach used to determine the assessed valuation of commercial properties, the overall assessed valuation changes which can lead to a higher mill levy for the entire community.

As illustrated on the next page, when the assessed valuation of a property is granted appeal and decreased, the other property owners' taxes increase. This affects residential property owners by increasing their taxes by more than $30 each. It also impacts other businesses who rely on local government services. Local business owners tend to understand the value of municipal services because they are also members of the local community. Using alternative property valuation to diminish the accurate amount of property taxes that big-box retailers should pay places the burden on other property owners.

Proactive Considerations

As more businesses utilize alternative property valuations in appealing appraisals, it is important for communities to share stories with all that will listen and prepare for any outcomes. Some steps to take include:

• Engaging Our Residents

The most important stakeholder in this issue is the resident, especially the residential property owners. Sharing the impact alternative property valuations could have on your community helps them understand why this issue matters and why they should support their local government leaders in any effort to support fair valuations that accurately determine the highest and best use of all properties. Home Rule authority allows cities and their residents the ability to decide what matters to them. When we engage our residents, we engage the State of Kansas.

• Small Business Partnerships

Many Kansas communities have functioning small businesses with brick-and-mortar stores in the downtown or central business district. These small businesses are local. They care about the communities they serve, and they want to see our communities thrive just as much as local government leaders do. Through sharing the issues related to alternative property valuation with our local, small businesses, our ability to show the impact of a limited tax base grows. This issue not only impacts our residents, but it will also impact small businesses, who have a better understanding of the services the local government provides.

• Collaborating with County Officials

County governments across the state are the primary stakeholders in valuation appeals in the State of Kansas; however, cities see the same, if not more, effects of reduced valuations. One major issue across the nation is the need for county appraisers to clearly explain their methods to resist the arguments made for alternative property valuations. By working with county officials and the country appraiser in your area to increase the understanding of the property valuation process for everyone, local government officials, small businesses, and residents alike will be more knowledgeable and prepared for these conversations.

Alternative property valuations can result in diminished services local governments provide throughout our communities, to our residents, and to future generations to come.

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WHY DO ACCURATE APPRAISALS MATTER?

What is Alternative Property Tax Valuation?

Alternative Property Tax Valuation occurs when a business appeals its county-appraised valuation and offers an alternative valuation for their property which is substantially lower. The alternative property valuation submitted often includes properties that do not have the same "highest and best use" as the owner's property and therefore are not comparable properties for assessment purposes.

Why Should Property Owners Care?

Cities set their budgets annually by calculating the cost of services to the community. This includes infrastructure maintenance, streets, police, fire/EMS, parks and recreation, and other common municipal services. For the scenarios below, the city has determined it needs $10,000 in tax revenues to provide these services to the community.

City of Anytown, Kansas: $10,000 in Property Tax Levied

Accurate Appraisals

Residential Property + **Commercial Property**

20 residential properties valued at $100,000 each (appraised value)
x
11.5% (residential assessment rate)
=
$11,500 in assessed valuation per residential property ($230,000 total)

2 commercial properties valued at $1,000,000 each (appraised value)
x
25% (commercial assessment rate)
=
$250,000 in assessed valuation per commercial property ($500,000 total)

The county appraiser's values are then used to determine a city's mill levy. A mill is $1.00 in property tax per $1,000 in assessed valuation.

$$\frac{(\$11,500 \text{ x } 20) + (\$250,000 \text{ x } 2)}{1,000} = \text{1 mill property tax levy} = \$730 \text{ tax revenue}$$

For this scenario, the city would use this formula to calculate a mill:

$$\frac{\$10,000 \text{ (property tax needed)}}{\$730 \text{ (1 mill tax levy)}} = 13.7 \text{ (city's mill rate)}$$

Total Tax Formula:
Residential property + Commercial property = $10,000 tax revenue

Residential property pays $157.55 each ($11.50 x 13.7 mill)

Commercial property pays $3,425 each ($250 x 13.7 mill)

Alternative Appraisal Approach Used

Residential Property + **Commercial Property**

20 residential properties valued at $100,000 each (appraised value)
x
11.5% (residential assessment rate)
=
$11,500 in assessed valuation per residential property ($230,000 total)

1 commercial property valued at $1,000,000 (appraised value)

1 commercial property valued at $500,000 (after appeal of appraised value)
x
25% (commercial assessment rate)
=
$250,000 + $125,000 in assessed valuation in commercial property ($375,000 total)

The county appraiser's values are then used to determine a city's mill levy. A mill is $1.00 in property tax per $1,000 in assessed valuation.

$$\frac{(\$11,500 \text{ x } 20) + (\$250,000 \text{ x } 1)+(\$125,000 \text{ x } 1)}{1,000} = \text{1 mill property tax levy} = \$605 \text{ tax revenue}$$

For this scenario, the city would use this formula to calculate a mill:

$$\frac{\$10,000 \text{ (property tax needed)}}{\$605 \text{ (1 mill tax levy)}} = 16.5 \text{ (city's mill rate)}$$

Total Tax Formula:
Residential property + Commercial property = $10,000 tax revenue

Residential property pays $189.75 each ($11.50 x 16.5 mill)

1 Commercial property pays $4,125 ($250 x 16.5 mill)

1 Commercial property pays $2,062.50 ($125 x 16.5 mill)