

TRAVIS CENTRAL APPRAISAL DISTRICT



2015

Commercial Valuation Analysis

Travis Central Appraisal District's examination of:

"An Analysis of TCAD's Commercial Valuations for City of Austin"

Prepared by:

Marya Crigler – Chief Appraiser

Lonnie Hendry, Jr. – Director of Commercial Appraisal

Patrick McCluskey – Senior Litigation Appraiser

TRAVIS CENTRAL APPRAISAL DISTRICT

EXAMINATION OF: "AN ANALYSIS OF TCAD'S COMMERCIAL VALUATIONS FOR CITY OF AUSTIN"

EXECUTIVE SUMMARY

The intent of this initial report/response is to expediently bring to light preliminary questions and concerns currently held by Travis Central Appraisal District's executive staff related to the "Property Valuation Analysis" commissioned by the City of Austin's City Council. Travis Central Appraisal District staff appreciates the current opportunity to increase their understanding and glean clarification of some of the items discussed in the "Property Valuation Analysis". TCAD would further welcome additional opportunities to discuss this matter; review the primary sales data relied upon to conduct the study, outline current TCAD practices as they relate to commercial valuation, and answer questions the Mayor or Council may have about TCAD's commercial appraisal processes.

The "Property Valuation Analysis" was performed by George W. Gau, Ph.D. (Watson Centennial Professor in Real Estate, Former Dean, McCombs School of Business, University of Texas at Austin) and Robert S. Radebaugh, MAI (Chief Executive Officer, Aegis Group, Inc., Austin, Texas) and is titled "An analysis of TCAD's Commercial Valuations For City of Austin."

The City of Austin adopted a resolution on June 12, 2014, (no. 20140612-065) stating in part that the City "Supports a fair and equitable property tax system.... Research conducted by the *Austin American-Statesmen*, *Real Values for Texas*, and others demonstrates that commercial property is often valued lower than actual sales prices and its real market value.... The undervaluation of commercial property imposes an unfair tax burden on residential property owners."

Upon adoption of the above reference resolution the City of Austin's purchasing department posted a Request for Qualification Statements (RFQS) Offer Sheet to its website on October 20, 2014 (solicitation no. RFQS 4400 JRD0500). The city additionally posted a Scope of Work (solicitation no. RFQS JRD0500) that outlined and defined the *purpose* of the solicitation as follows:

"The City of Austin seeks qualification statements from firms or individuals qualified and experienced in providing property valuation services on commercial property categories. The purpose of this project is to compile comprehensive evidence for a potential targeted challenge petition challenging the appraisal categories of commercial properties that can be proved to be undervalued. Evidence must comply with Chapter 41 of the Texas Property Tax Code. The selected firm must be willing and qualified to testify regarding the analysis performed. The Contractor will be responsible for performing a comparative analysis of the TCAD values on commercial property categories within the City of Austin with an independent market value of the property categories to determine whether there is a value variation."

The City placed a deadline of 12:00 PM, Wednesday, November 12, 2014 for responses to the request for qualifications. Based upon the RFQS Evaluation Matrix the City minimally received three responses from the following firms:

- The Aegis Group, Inc – Austin, TX
- Hammerman & Gainer, Inc. – Austin, TX
- Titan Commercial Valuation, LLC – Austin, TX

The firms were scored using the attached RFQS Evaluation Matrix:

RFQS EVALUATION MATRIX
Property Valuation Analysis
JRD0500

EVALUATION FACTORS	# Possible Points	The Aegis Group, Inc. Austin, TX	Hammerman & Gainer, Inc. Austin, TX	Titan Commercial Valuation, LLC Austin, TX
APPROACH TO APPRAISAL PROBLEM	35	28	22	19
PROFESSIONAL QUALIFICATIONS FOR SCOPE OF WORK	25	21	18	14
RELEVANT EXPERIENCE AND EXPERTISE	20	18	15	9
UNDERSTANDING OF RELEVANT TAX CODE AND TAX APPRAISAL PRACTICES	20	18	13	13
DEMONSTRATED CAPABILITY TO COMPLETE ASSIGNMENT	20	16	13	13
DEMONSTRATED LACK OF CONFLICT OF INTEREST	10	8	8	10
Total	130	106	88	76

The Aegis Group, Inc. was scored the highest and therefore awarded the \$380,000 contract to complete the "Property Valuation Analysis" as outlined by the request for qualifications and scope of work.

The Aegis Group, Inc. completed their report on May 11, 2015 and submitted it to the City Council for review at some point on or after that date.

On the May 14, 2015 City Council Agenda, agenda item no. 27 listed under executive session stated the following:

"Discuss legal issues associated with City Council Resolution No. 20140612-065 that directs the City Manager to file a challenge petition with the Travis County Appraisal Review Board relating to commercial property values in the City set by the Travis Central Appraisal District (Private consultation with legal counsel—Section 551.071)."

Following the executive session discussions held on May 14th, the *Austin American Statesman* ran an article on its website May 15, 2015 that stated, "Austin City Council Member Kathie Tovo is calling for the city to file a petition challenging commercial appraisals based on a city-commissioned study that apparently

found such properties were undervalued." It was at this time that word began leaking out the study indicated TCAD had under appraised commercial property by over 40%.

The Council held an additional meeting and workshop discussing the Challenge Petition on Tuesday, May 19, 2015. The Mayor and the council met with city staff and others during a workshop to discuss some of the logistical and legal aspects of filing a challenge petition. The workshop was accessible via web stream and representatives of the Travis Central Appraisal District watched the discussion(s) as they were taking place. The reality of unintended consequences and fallout was a message being delivered by Mayor Adler. The fallout for the other taxing entities in Travis County could be substantial and the unavoidable delays caused by a challenge petition could disrupt many government entities from being able to fulfill their financial obligations.

The mayor requested the "Property Valuation Analysis" be made public and available for review by the city's residents and other interested stakeholders. The posting of the "analysis" allowed Travis Central Appraisal District representatives to read the report's determinations and conclusions.

Unfortunately, the report did not provide any of the background sales data that was relied upon to make the assertions of under valuation. It did however, state, in the executive summary,

"Austin commercial properties have been substantially undervalued by TCAD for property tax purposes. For the period of 2012-2014, the average undervaluation was 47% when measured by the median of the ratio of the property's sales price to its TCAD appraised value at the time of sale.... The greatest undervaluation was for unimproved and under-improved land. The average undervaluation for 2012-14 was 92% for this commercial property type."

At first glance, the analysis seems very convincing that TCAD's appraisal values are "undervalued" relative to their sales prices. The remainder of the report contains limited data and tables that seem to implicate TCAD's values as systemically undervalued over the 2012-2015 timeframe. However, the report does not detail, show, or indicate what property sales the report writer(s) utilized in their analysis. It does not give detailed breakdowns of adjustments made to the sales beyond time and leased-fee vs fee simple.

TCAD's staff has done a very rapid but thorough review of the "analysis" in the short time frame consisting of May 19 – May 25. After reviewing the analysis, it became apparent that several items in the statistical analysis were vague, potentially misrepresented, and painted a picture that wasn't what was being described by the Council, County Commissioner, and Mayor.

Below, TCAD will outline, at a macro-level some of the major concerns TCAD has with this analysis, report, and its findings. Our hope is that with TCAD bringing to light these inquiries a more objective review of the analysis and its findings (or lack of) can be brought to the discussion table prior to a challenge petition being filed.

MASS APPRAISAL OVERVIEW

Every appraisal district in the State of Texas must follow the statutes and requirements of the Texas Property Tax Code (Code) and The Uniform Standards of Professional Appraisal Practice (USPAP) when valuing properties in their jurisdictions. The Texas Property Tax Code and USPAP define and/or guide the appraisal districts with regard to market value and a myriad of other appraisal related functions and responsibilities.

USPAP defines mass appraisal as, "the process of valuing a universe of properties as of a given date using standard methodology, employing common data, and allowing for statistical testing."

The appraisal district is charged with valuing an entire universe of properties, i.e. commercial, residential, business personal property, etc. TCAD must use standard methodology in conformity with their requirements to comply with the Code and/or USPAP. Examples of standard methodology would be the utilization and implementation of the different generally accepted appraisal methodologies; cost approach, sales comparison approach, or the income approach. TCAD then employs the use of common data to the standard methodologies to render reliable data driven results that can be statistically tested. Common data would be data that can be applied across the universe of properties without bias. Examples of common data would be a property's square footage, year built, market rent, market occupancy, etc. The statistical testing element is equally important because it helps determine if the mass appraisal models are accurate or need to be adjusted.

The Texas Comptroller of Public Accounts, (property tax division) tests half of the appraisal districts every other year using a statistical testing measure to ensure their appraisals are representative of market value.

Section 5.10 of the Code states the following related to the statistical testing component of mass appraisal:

(a) At least once every two years, the comptroller shall conduct a study in each appraisal district to determine the degree of uniformity of and the median level of appraisals by the appraisal district within each major category of property. The comptroller shall publish a report of the findings of the study, including in the report the median levels of appraisal for each major category of property, the coefficient of dispersion around the median level of appraisal for each major category of property, and any other standard statistical measures that the comptroller considers appropriate. In conducting the study, the comptroller shall apply appropriate standard statistical analysis techniques to data collected as part of the study of school district taxable values required by Section 403.302, Government Code.

(b) The published findings of a ratio study conducted by the comptroller shall be distributed to all members of the legislature and to all appraisal districts.

(c) In conducting a study under this section, the comptroller or the comptroller's authorized representative may enter the premises of a business, trade, or profession and inspect the property to determine the existence and market value of property used for the production of income. An inspection under this subsection must be made during normal business hours or at a time mutually agreeable to the comptroller or the comptroller's authorized representative and the person in control of the premises.

TCAD's commercial valuations have been tested by the Comptroller of public accounts for accuracy and validity.

The underlying fundamentals of the commercial real estate market are very dynamic in Travis County. Austin is the state's capital and provides an inordinate amount of opportunity relative to other parts of Texas. Documenting and valuing commercial real estate, given the fluidity of commercial transactions and development is a challenging task especially with the lack of actual market data statutorily required to be disclosed. However, in the face of these challenges TCAD has been proactive by continually adapting its processes to the ever changing marketplace. TCAD feels it accurately values commercial properties based upon the established statistical testing measures currently enforced by the property tax division of the State Comptroller's office.

DEFINITIONS

It is imperative with any type of study, report, analysis, or review that each of the intended participants and recipients fully understand the terminology and techniques being utilized so the chances of major components being lost in translation are minimized. If uncommon terminology such as statistical references or measures are being utilized it creates an increased opportunity for confusion and misinterpretations of fact. Appraisal terminology is also uncommon to most people not directly involved in the appraisal profession. Detailed definitions of key appraisal related terms are a necessity for adequate comprehension of certain components located within this report and others. Below TCAD will attempt to explain some of the confusion created by the use of the term "undervaluation".

UNDERVALUATION DEFINED

The study takes a sample set of sales including offices, retail properties, industrial properties, vacant land and undeveloped land that sold or closed in 2012, 2013, 2014 or the first three months of 2015. The study then screens the sales to see if they should be included in the study. Reasons for not using some of the sales are loosely described on page 16 of the analysis. There were originally 1,860 parcel sales identified by the author(s) but that list was whittled down to 735 parcels in 429 transactions; presumably for the reasons identified on page 16. Next, the remaining sales were adjusted for transaction conditions and then adjusted for time. The time adjustments were made at the rate defined in the report on Page 21. These adjustments were made to reflect the indicated sales price as of January 1 of the next year and/or back to January 1 prior to the actual sales date.

After the sales were adjusted to January 1 of the previous year and/or the following year, the Adjusted Sales Price (ASP) was then compared to the Assessed Value (AV) of the property the Travis Central Appraisal District determined to be market value on January 1 of that year.

On page 23, the study defines undervaluation as the "percentage by which the TCAD appraised values (AV) would need to increase to have them equal the adjusted sales prices (ASP). The study then compares the ASP to the AV by applying the following formula:

$$(ASP/AV) - 1 = \text{UNDERVALUATION}$$

On page 3, the report says that "for the period 2012-2014, the average undervaluation was 47%" and further on the page it says "Austin commercial properties through 2014 would have needed to increase by an average of 47% before the properties would be assessed at their market values".

The use of the term undervaluation in the study is confusing and possibly misleading. Most people would believe that if something is being undervalued by 20%, then it is lower than its true value by a measure of 20%.

For example, if a parcel of land had a market value of \$10,000 and it was undervalued by 20% it would be priced at \$8,000. **That is not what the study is reporting.** The formula for undervaluation shown above would calculate and represent the land to be undervalued by 25%. The formula calculates the amount the price would have to rise to achieve 100% of it's market value, which is different than the generally accepted interpretation of something being undervalued.

The example below shows how the study would define undervaluation in this example:

$$\begin{aligned} \text{MARKET VALUE} &= \$10,000 \\ \text{PRICE} &= \$8,000 \\ (\$10,000/\$8,000) - 1 &= 25\% \text{ (undervalued)} \end{aligned}$$

The percentage that the price of the parcel is discounted or below market value is actually 20% as illustrated below:

$$\begin{aligned} \text{MARKET VALUE} &= \$10,000 \\ \text{PRICE} &= \$8,000 \\ (\$10,000 - \$8,000) &= \$2,000; (\$2,000/\$10,000) = 20\% \text{ (undervalued)} \end{aligned}$$

The difference in terminology is significant in this study since there is a twenty-five percent difference between a 20% undervaluation and a 25% undervaluation. The study is impacting billions of dollars on the tax roll so a 25% difference attributed to terminology is significant.

The calculated difference between the study's definition of undervalued and the generally accepted method of undervalued can be seen below:

$$(25\% \text{ (from the study)}/20\% \text{ (generally accepted)}) - 1 = 25\%$$

TIME ADJUSTMENT

There is also serious concern about how the study calculated the time adjustment(s) and how they were applied. The study adjusted all the sales for time forward to January 1 of the year following the sale and back to January 1 of the year of the sale. It is not clear if the sales prices are time adjusted for more than the current year and following year. It is possible, even probable that the sales are adjusted and used in the study for multiple years.

Questions: If a sale closed January 2, 2012, was that sale time adjusted to January 1, 2012, 2013, 2014 and 2015? Was the sale of January 2, 2012 only used in the 2013 undervaluation study? The report does not give any details about this and is certainly not clear.

On page 21, the Time Adjustments by property type are calculated. The property types are office, retail & miscellaneous, industrial and apartment land. The time adjustments for the commercial properties are calculated by starting with asking rents on a triple net basis. The study calculates the time adjustment by capitalizing the asking rents minus the vacancy rate. The concluded values per square foot are compared to each other on an annual basis and the indicated time adjustment is calculated per year and month.

Office

The time adjustment utilized for office properties in the study are shown below. The study concludes the price per square foot used in the time adjustment for each year is as follows:

- \$275.09 per square foot in 2011;
- 290.74 per square foot in 2012;
- 338.43 per square foot in 2013 , and;
- \$366.62 per square foot in 2014

The 3 year and 3 month appreciation calculates to total appreciation of 33%.

*Note there were not any operating expenses in the following income approaches. (Chart below)

The time adjustments per month from the following chart were applied to the number of months necessary to adjust each sale to arrive at the Adjusted Sales Price (ASP) as of January 1, of the year following the sale and the year of the sale.

On page 17, the study shows that the office portfolio was delineated by size; offices larger than 35,000 square feet were labeled large office and those smaller than 35,000 square feet were labeled small office.

According to the TCAD records, there are 2,929 office parcels in the city of Austin. Many office properties contain multiple parcels. The offices range in year of construction from 1880 to 2015 and in size from less than 1,000 square feet to 1,761,971 square feet. The time adjustment from the chart was applied to all the sales in the study regardless of the age, quality, size or location of the property.

Office	2011	2012	2013	2014
Asking Rent (triple net)	\$23.17	\$24.00	\$26.04	\$26.71
Vacancy Rate	11.80%	10.10%	9.30%	8.60%
Cap Rate	7.43%	7.42%	6.98%	6.66%
Price Indices	\$275.09	\$290.74	\$338.43	\$366.62
Annual % Change		5.69%	16.40%	8.33%
Monthly % Change		0.47%	1.37%	0.69%

RETAIL & MISCELLANEOUS

The time adjustment for retail and miscellaneous from the study is shown below:

Retail & Miscellaneous	2011	2012	2013	2014
Asking Rent (triple net)	\$19.64	\$19.96	\$19.76	\$20.68
Vacancy Rate	5.9%	5.3%	4.9%	4.7%
Cap Rate	7.16%	7.06%	6.98%	7.05%
Price Indices	\$258.06	\$267.80	\$269.28	\$279.57
Annual % Change		3.77%	0.55%	3.82%
Monthly % Change		0.31%	0.05%	0.32%

The same underlying issues remain with the application of the time adjustments to the retail and miscellaneous property types that were described in more detail above with the office portfolio.

INDUSTRIAL

The time adjustment for industrial from the study is shown below:

Industrial	2011	2012	2013	2014
Asking Rent (triple net)	\$7.75	\$7.34	\$8.68	\$9.21
Vacancy Rate	11.8%	8.9%	7.8%	8.2%
Cap Rate	8.71%	8.54%	7.83%	7.53%
Price Indices	\$78.46	\$78.31	\$102.17	\$112.32
Annual % Change		-0.20%	30.47%	9.94%
Monthly % Change		-0.02%	2.54%	0.83%

The same underlying issues remain with the application of the time adjustments to the industrial property type that was described in more detail above with the office portfolio.

APARTMENT LAND

The time adjustment(s) for the land transactions utilized in the study are shown below:

Apartment (Land)	2011	2012	2013	2014
Rent (annualized)	\$13.92	\$14.46	\$15.72	\$16.44
Vacancy Rate	4.72%	5.12%	4.98%	6.00%
Expense Ratio	45.0%	45.0%	45.0%	45.0%
Cap Rate	5.80%	5.72%	5.80%	5.36%
Price Indices	\$125.77	\$133.56	\$141.65	\$158.57
Annual % Change		6.20%	6.05%	11.95%
Monthly % Change		0.52%	0.50%	1.00%

The study applied the time adjustment for *improved* apartments to vacant land in all categories. The appreciation rate for an income producing apartment complex may or may not reflect the appreciation (if any) for vacant land that has costs associated with its holding period. The land parcels that sold may have had all entitlements and building permits at the time of sale, so a commercial project could begin construction immediately after the transaction closed.

Vacant tracts of land can be marketed for years and then go under contract. They may be under contract for one or two years while the entitlements are worked out. When these tracts close, the price normally reflects the value of the entitlements and the fact that the seller had them under contract without receiving the proceeds of the sale for a long period of time.

The study does not address these issues, but rather it applies the appreciation rate from improved apartments to land in all categories.

TIME ADJUSTMENT ILLISTRATION

On page 20, the report has an illustration of the application of their time adjustment to transaction 1 (outlined in red) in Exhibit B-1, seen below:

Exhibit B-1										
Sample Example										
TCAD										
#	State Code	Property Code	Study Code	Land Size (AC)	Land Size (SF)	Building Size	Location Submarket	Combined Location	Date of Sale	Sales Price
1	F1	50	OFL			178,806	CBD	C	May, 2012	\$49,000,000
2	F1	46	RTL			55,276	NC	C	December, 2012	\$9,500,000
3	F1	86	INS			19,888	NE	S	June, 2014	\$1,625,920
4	C1	VL	VL	0.6271	27,316		N	S	November, 2013	\$240,000
5	F1	31	VL-I	0.76	32,670	820	EC	C	December, 2013	\$2,755,471

This transaction was an office building that sold in May 2012 for \$49 million. The report says to find its sales price as of January 1, 2012; the sale was discounted by 1.88% (4 x 0.47%) from Exhibit B-3) or \$921,000 to derive an adjusted market value of \$49,921,200 at the start of 2012. This is a major error since they added the \$921,000 to the sales price instead of subtracting it from the sales price.

If the market for offices is appreciating, the appreciation that occurred between January 1, 2012 and the sale date of May 2012 must be **subtracted** from the transaction price. If the study subtracted the \$921,000 from the transaction price, the sales price on January 1, 2012 would have been \$48,079,000* (see following paragraph) not \$49,921,200 as reported.

There is an error in the way the author(s) calculate their time adjusted transaction price when they time adjust a sale back to a prior date. In the above scenario, the report says the office market was appreciating at 0.47% per month and the total difference between January 1, 2012 and the transaction date of May 2012 would be 1.88%. When the sales price on January 1, 2012 of \$48,079,000* (see above correction) is adjusted for 1.88% appreciation, the transaction price is calculated to be \$48,982,885. The transaction price was actually \$49,000,000. Some might say this is close enough but this error was repeated over and over every time a transaction price was backed up to a prior date.

In this example the time adjustment backwards was only four months. If the time adjustment was eleven months, the error would have been much greater. If the transaction price was backed up two years, the error could/would be significant.

The proper method for time adjusting a transaction (sales price) to a prior date is to divide the transaction price by the appreciation rate. In the above example, the transaction price was \$49,000,000 and the four months' time adjustment between January 1, 2012 and the transaction date of May 2012 was 1.88%. Both of these figures are from the report on page 20 in their time adjustment illustration.

When the transaction price is divided by the appreciation rate, the adjusted price on January 1, 2012 would calculate to \$48,095,799 ($\$49,000,000 / 1.0188 = \$48,095,799$).

Now when the time adjustment is applied to the January 1, 2012 sales price the adjusted price is \$49,000,000 ($\$48,095,799 \times 1.0188 = \$49,000,000$).

SALES

The report says on page 17 under Sample Example sale 5 is shown to have closed in December 2013 and it was used in the study as a vacant land sale VL-1 and also as a commercial F1 sale, see below (outlined in red):

Exhibit B-1
Sample Example

TCAO										
#	State Code	Property Code	Study Code	Land Size (AC)	Land Size (SF)	Building Size	Location Submarket	Combined Location	Date of Sale	Sales Price
1	F1	50	OFL			178,606	CBD	C	May, 2012	\$49,000,000
2	F1	46	RTL			55,276	NC	C	December, 2012	\$9,500,000
3	F1	66	INS			19,888	NE	S	June, 2014	\$1,625,920
4	C1	VL	VL	0.6271	27,316		N	S	November, 2013	\$240,000
5	F1	31	VL-1	0.75	32,670	820	EC	C	December, 2013	\$2,755,471

This parcel contained an 820 square feet building (at the time of sale) to be torn down; with a sales price of \$2,755,471. The sales price calculates to \$3,360 per square foot of improvements. Even the purchaser said he was going to tear down the improvements.

Question: Why would this sale be utilized twice in the study?

Sales that are used more than one time and classed as both vacant land and commercial transactions can skew the study results and undermine the integrity of the study. This clearly appears, and was attested to by the owner, to be a vacant land sale.

DATA

All appraisers in the mass appraisal field, in government offices, in condemnation, in fee appraisals and in all levels of valuation use the most current data and sales in making market value estimates. The Travis Central Appraisal District utilizes the most current sales, rent studies, capitalization rate studies and market surveys available. TCAD subscribes to CoStar, LoopNet, Marshall Valuation Service, Austin Area Apartment Survey, Austin Office Market Survey, Austin Area Multi-Tenant Retail Survey, Austin Investors Interest, Austin Business Journal, Annual PKF Trends Consulting, REIS Services, Realtyrates.com, and Real Estate Research Corporation.

TCAD has key staff members in leadership roles that have pioneered several "data mining" techniques that are unique to their appraisal district. Their staff has spoken at conferences and lead training seminars on "data mining". TCAD uses every available resource, public and private, to have the most current and relevant data.

However, Texas does not have mandatory sales disclosure. The lack of sales disclosure prohibits the appraisal district from knowing most transactions actual sales prices. This is an important concept to understand. The appraisal district is required to utilize generally accepted appraisal techniques and comply with USPAP and the Texas Property Tax Code. TCAD is also working towards a distinctive IAAO certification. Each of these entities requires proper vetting and verification of data, particularly sales data, prior to it being implemented in the mass appraisal models.

When a sales price is published in the newspaper, it doesn't mean the appraisal district can utilize that article as a source for verifying the sales price without additional generally accepted documentation

DATA ANALYSIS WITHIN THE "ANALYSIS"

The time adjustments that are described in the analysis state/imply that sales are adjusted forward to January 1 of the year following the sale and back to the prior January 1 within the same year of the sale. In this example if a property sold on June 15, 2014 it would be adjusted forward to January 1, 2015 to assess how accurate the appraisal district valued the property in the year following the sale.

Additionally, for purposes of determining if TCAD had undervalued the property in the year of the sale, i.e. 2014, the sales price would be time adjusted back to January 1, 2014 and compared to the 2014 appraised value. At first glance it may appear appropriate to make these forward and backward time adjustments. However, the backward time adjustment of sales that occurred after March 31 of any given year would be invalid for use in the analysis.

The appraisal district must mail notices of appraised value on or be May 1st of each year. In order for this to occur timely the appraisal district must "cut off" their analysis of data at some point in the process to facilitate the logistical requirements of creating, stuffing, and mailing said notices of appraised value.

TCAD's "cut off" for purposes of data analysis occurs on March 31st of any given year. Therefore, any sale that takes place after March 31st by definition was unavailable for use in their analysis due to the fact it hadn't occurred. The appraisal district cannot predict sales prices or market trends. The appraisal district's role is to reflect the market, not predict or create it.

TCAD'S practices related to how it analyses sales are described below in more detail:

- The assessment date is January 1 and under the tax calendar established by the legislature all valuation must be completed in the first quarter of the year. As a result Travis CAD, and all other appraisal districts in the state, looks at the sales transactions that occurred in the *previous* year when determining the current year's appraised values.
- In the conclusions drawn in the executive summary of this study on page 3 the authors rely on a comparison of values to sales in the calendar year rather than a comparison to sales in the previous year. We strongly feel that this is not the appropriate methodology to use since it is contrary to the way the appraisal district is required to operate.
- Hindsight is always 20/20, but to establish values and defend them in the equalization phase the appraisal district must use known data. Even if there was full sales disclosure in the state, the appraisal district would not be able to meet the standard set by the methodology of comparing appraised values to sales in the calendar year because at the time the appraisals are performed the data does not exist; i.e. the sales have not occurred at the time of appraisal and data analysis..
- Conclusions about the rate of appreciation or time adjustment can **only** be calculated in hindsight. What if the market were to crash in the second quarter of 2015 and real estate values plunge like they did in the great recession of 2009? To have relied on a predicted time trend of appreciation for sales that have not yet occurred would result in values that are vastly over appraised rather than under appraised values. It would be inappropriate for the appraisal district to speculate on what "might" be rather than reflect what "has" occurred.

The authors concede this point on page 11 of the report where they state "Because of the larger number of 2014 transactions in this test, this result is a better indication of the likely undervaluation in the 2015 initial appraised values than the test with the smaller number of 2015 transactions". They do conduct an analysis on page 11 of the appraisal district's performance using the previous year's sales and comparing them to the current values. Their conclusions are substantially different than what's stated in the executive summary and indicate TCAD's undervaluation (even when using their methodology) is significantly less. TCAD struggles to understand why the flawed methodology was used in the executive summary when they state later in the report the comparison to previous years' transactions result in a better indication of the likely undervaluation.

Unfortunately, the overstated undervaluation that was cited in the executive summary is the hyperbole that was making headlines in the newspaper and other media outlets.

Pages 15 and 16 of this report will focus greater attention to detail to the actual reported undervaluation for 2015 using the city council's commissioned "analysis".

ISSUES NEEDING CONSIDERATION - POTENTIAL CHALLENGE TO THE 2015 APPRAISED VALUES

TCAD is required to follow the Texas Property Tax Code as well as the Uniform Standards of Appraisal Practice.

Section 23.01 of the Texas Property Tax Code says:

SUBCHAPTER A

APPRAISALS GENERALLY

Sec. 23.01 Appraisals Generally

- (a) Except as otherwise provided by this chapter, all taxable property is appraised at its market value as of January 1.
- (b) The market value of property shall be determined by the application of generally accepted appraisal methods and techniques. If the appraisal district determines the appraised value of a property using mass appraisal standards, the mass appraisal standards must comply with the Uniform Standards of Professional Appraisal Practice. The same or similar appraisal methods and techniques shall be used in appraising the same or similar kinds of property. However, each property shall be appraised based upon the individual characteristics that affect the property's market value, and all available evidence that is specific to the value of the property shall be taken into account in determining the property's market value.

In addition to the market value requirement, the Texas Property Tax Code addresses unequal appraisals in the following sections:

SUBCHAPTER C

TAXPAYER PROTEST

Sec. 41.41 Right of Protest

- (a) A property owner is entitled to protest before the appraisal review board the following actions:
- (2) unequal appraisal of the owner's property;

Sec. 41.43 Protest of Determination of Value or Inequality of Appraisal

- (a) Except as provided by Subsections (a-1), (a-3), and (d), in a protest authorized by Section 41.41(a)(1) or (2), the appraisal district has the burden of establishing the value of the property by a preponderance of the evidence presented at the hearing. If the appraisal district fails to meet that standard, the protest shall be determined in favor of the property owner.
- (b) A protest on the ground of unequal appraisal of property shall be determined in favor of the protesting party unless the appraisal district establishes that:
 - (1) the appraisal ratio of the property is equal to or less than the median level of appraisal of a reasonable and representative sample of other properties in the appraisal district;
 - (2) the appraisal ratio of the property is equal to or less than the median level of appraisal of a sample of properties in the appraisal district consisting of a reasonable number of other properties similarly situated to, or of the same general kind or character as, the property subject to the protest; or
 - (3) the appraised value of the property is equal to or less than the median appraised value of a reasonable number of comparable properties appropriately adjusted.

For example, if a suburban office building sells on December 31, 2014 for \$200 per square foot, the appraisal district may not be able to value that property on January 1, 2015 for \$200 per square foot if the rest of the suburban offices similar to the transaction are being valued at \$180 per square foot.

Equal and uniform statutes would trump market value in this case unless the entire portfolio of similar properties was valued at \$200 per square foot. One sale does not make the whole market. The appraisal district is required to have clear and convincing evidence in a protest. The "burden of proof" is statutorily on the appraisal district when valuing properties for ad valorem purposes.

Equal and Uniform laws are a powerful factor that must be considered in a study like the one commissioned by the city council.

2015 VALUES

On page 11, the study says: "The median undervaluation of the 2014 transactions found in the 2015 initial TCAD appraisals is 16%." This figure uses the study's undervaluation calculation; the generally accepted methodology would indicate the 2015 values are at 86% of market value before adjustment for time.

The time adjustments to the 2014 sales from page 21 of the study are shown to be 8.33% for office, 3.82% for retail & miscellaneous, 9.94% for industrial and 11.95 % for apartment land. The average of these time adjustments is 8.51% and half of that is 4.26%. The annual average time adjustment was divided by 50% since it is assumed that half the 2014 sales occurred in the first half of the year and half occurred in the last half of the year.

The Travis Central Appraisal District does not time adjust the sales' prices that occur within the twelve months before a January 1 valuation. The Texas Property Tax Code requires clear and convincing evidence to defend a protest and all properties are required to be valued equally and uniformly.

A rent study, using asking rents, on a pro forma income analysis that does not even include operating expenses is not clear and convincing evidence.

When half of the average appreciation for 2014 is subtracted from the undervaluation results for 2015, the undervaluation can be restated to 11.74% ($16\% - 4.26\% = 11.74\%$).

The next step is to calculate the actual percent the study indicates that the TCAD 2015 noticed market values are under the sales prices (refer to page 1).

In order to show the recalculation, we will use a hypothetical transaction of \$1,000 in 2014 unadjusted for time. If the TCAD noticed value needs to be adjusted up by 11.74% to reach the transaction price that would mean that the noticed value was \$895 ($\$1,000 / 1.1174 = \895). That is a difference of \$105 between the transaction price and the 2015 noticed value ($\$1,000 - \$895 = \$105$). The \$105 is 10.5% of the sales price of \$1,000 ($\$105 / \$1,000 = 10.5\%$).

In summary, according to the report, the 2015 noticed values from TCAD are 16% undervalued when the most recent transactions of 2014 are considered. When half the 2014 average appreciation rate is subtracted since there is not convincing evidence as required by the Texas Property Tax Code, the undervaluation is restated to 11.74%. That figure represents the amount the study shows the noticed values for

2015 would need to rise to meet the 2014 transactions not considering a time adjustment. **When the methodology used in the study is converted to the percent the noticed values are relative to the sales prices, that figure is reduced to approximately 10.5%. That means, using the sales data utilized in the study, the 2015 TCAD noticed values are approximately within 89.5% of the 2014 sales prices.**

If TCAD were to revalue the property types noted in the study, it is very doubtful there would be any meaningful difference to the current noticed values.

All of the statistics and figures in the study that reference the TCAD under valuations in 2012, 2013 and 2014 are not applicable to the 2015 values as shown above.

Based on the available data to both TCAD and the author(s) of the analysis, TCAD has accurately reflected market values of the commercial property located in the city of Austin and Travis County in 2015.

CONCLUSION

Travis Central Appraisal District takes its charge of valuing all taxable property at 100% of market value very seriously. They have assembled a team of very qualified staff members to ensure their fiduciary responsibilities are met. TCAD employs staff with varied professional real estate backgrounds ranging from development/construction, leasing and property management, brokerage, state licensed (fee) appraisal, geographic information systems, information technology, etc. They have several staff members with advanced degrees, state licenses, and/or member of the appraisal institute designation, in addition to the state mandated requirements incumbent upon those working in the ad-valorem appraisal field.

This does not mean that TCAD is not capable of making mistakes, but it does show how committed TCAD is to being proactive, striving to attract and keep top talent, in an effort to be the best most efficient and effective appraisal district in the State of Texas.

TCAD welcomes and acknowledges the need for transparency in its processes, procedures, and results. However, commissioning a report for, "The purpose of this project is to compile comprehensive evidence for a potential targeted challenge petition challenging the appraisal categories of commercial properties that can be proved to be undervalued" seems somewhat biased and contentious.

TCAD is hopeful that a more thorough analysis of its data, in addition to the actual underlying sales data from the analysis (that hasn't been seen at this point), can be presented and reviewed by the Mayor and the City Council. If that occurred it would present a more comprehensive picture of the actual valuation levels currently being assessed on commercial properties located in the city of Austin and Travis County.

TCAD is confident in the results of their 2015 values as they are measured against the universe of sales that had taken place as of March 31, 2015.

We appreciate the opportunity to present this initial report and are prepared to move forward in the most amicable way possible in lieu of a challenge. However, we are also prepared (if necessary) to present the compulsory data to prevail should the city choose to pursue a challenge petition of the 2015 commercial values.

