

CITY COUNCIL MINUTES
SPECIAL MEETING

KERRVILLE, TEXAS
JULY 11, 2014

On July 11, 2014, at 2:11 p.m. the Kerrville City Council attended a hearing of the Kerr Central Appraisal District (KCAD) Appraisal Review Board (ARB) pursuant to Section 41.05 of the Texas Tax Code, held at the Upper Guadalupe River Authority Lecture Hall at 125 Lehmann Drive, Kerrville, Texas.

COUNCILMEMBERS PRESENT:

Jack Pratt	Mayor
Stacie Keeble	Councilmember
Gary Stork	Councilmember

COUNCILMEMBERS ABSENT:

Carson Conklin	Mayor Pro Tem
Gene Allen	Councilmember

CITY EXECUTIVE STAFF PRESENT:

Todd Parton	City Manager
Mike Hayes	City Attorney
Brenda G. Craig	City Secretary
Ashlea Boyle	Special Projects Manager
Sandra Yarbrough	Director of Finance
Amy Dozier	Assistant Director of Finance

MEMBERS OF THE APPRAISAL REVIEW BOARD PRESENT:

Charles Torti, Chairman
John Higbie
William Rich
Charles Whittier
Milton Morse
Judith Hargrove, ARB Attorney

Mr. Torti called the meeting to order and noted the purpose was to hear evidence on the challenge petition by the City of Kerrville on the level of appraisals of a category of property, specifically the market value that KCAD placed on commercial property in the city, particularly in the downtown area.

Persons presenting evidence to the ARB were sworn in:

City of Kerrville: Jack Pratt, Mayor; and Todd Parton, City Manager; both acknowledged they were not licensed and did not hold a certificate from the Texas Appraisals, Licensing and Certification Board.

Kerr Central Appraisal District: P.H. "Fourth" Coates, KCAD Chief Appraiser; Gary Zigler, Eagle Appraisal and Consulting; Peter Lowe, KCAD General Counsel; and Michael Folmer, KCAD senior appraiser. All except Mr. Lowe confirmed they did hold a certificate from the Texas Appraisals, Licensing and Certification Board.

Mr. Torti asked if any member of the ARB had discussed the challenge with anyone presenting evidence; all ARB members responded no. Affidavits were signed by all sworn persons and provided to the secretary of the ARB.

Mr. Torti noted the ARB was a quasi-judicial board independent from and not part of or beholden to KCAD or any taxing entity. The ARB would hear evidence from all parties regarding appraisal of commercial properties within the area. After presentation of all evidence, the ARB would make its ruling. Under the Tax Code the city must demonstrate evidence that the appraisal ratio of the representative properties in the challenge category were not correct; KCAD must demonstrate evidence that representative properties in the challenge category were correct. Mr. Torti asked the city to better identify the properties in question; Mayor Pratt noted all commercial property county wide.

Mayor Pratt noted the appraisals in question affected 16 taxing entities. This unprecedented challenge by the city was taken out of concern for its citizens and the economic viability of the community based on the following:

- KCAD commercial appraisals for 2014 were significantly higher than 2013.
- The appraisal process for 2014 did not accurately reflect Kerrville's local conditions and economic factors.
- Results of the appraisal method were detrimental to Kerrville's economic growth.
- The economic impact would delay Kerrville's recessionary period recovery.
- No apparent consistent, fair and equitable methodology was used. The methodology used was not in the best interest of commercial and residential customers and was not fair, equitable or consistent.

Mayor Pratt noted the city's budget was not based on a tax rate but on a tax levy.

Mr. Parton noted the increased appraisals were not consistent with factors in the community. He presented data on historical appraisals from 2006-2014 and noted the 2014 commercial appraisals represented the most significant fluctuation in appraised values. 2014 land appraisals increased 15.2% over 2013; increases back to 2006 ranged from -0.7% to 5.3%; 2014 improvement appraisals increased 10.7% over 2013; and increases 2006-2013 ranged from -3.0% to 7.0%. The strongest economic conditions were in 2007-2008. A random sample of 30 commercial properties indicated that from 2013 to 2014, 18 properties increased over 30%; 7 properties increased over 70%; and the average increase in structure/improvement was 40%; the average increase in land value was 35%; the average increase in total valuation was 39%. Economic conditions indicated rental rates were flat with 95 storefront vacancies documented for 55 commercial properties, and property sales were flat for several years with very few transactions for comparative pricing and benchmarking. He also provided evidence that the rate of increase on property value was contrary to market conditions, citing low CPI indices and low 10-year T-bill return rates over the past several years. Due to the lack of local market information, Mr. Parton proposed developing a mechanism to

establish appraisals based on a cost basis approach that would establish the cost to replace improvements less depreciation.

The Marshall & Swift (M&S) procedure was a commonly accepted method of appraisal. M&S used a regional modifier to adjust for market specific conditions, for example, San Antonio was used as the regional multiplier for Kerr County, and additional local factors were used for local market specific conditions. 14 total sales were used: 7 sales between 6-1-99 and 5-2-06; 6 sales between 6-26-08 and 11-15-11; and 1 sale from 9-18-13, which was accidentally reported as a property sale in the amount of \$650,000, but was actually property converted from condominiums to commercial property by the owner and no sale or transaction took place. Mr. Parton opined that M&S results were not a true reflection of local commercial property for the following reasons: lack of property sales data to compare; "soft" data with regard to commercial land value as there was not a high demand pushing values; property income had not increased for several years; an excess supply (vacant properties) of commercial property; and modest increases in sales prices over the past several years.

Mayor Pratt quoted from an independent appraisal made in August 2010, "Vacancies and collection loss of buildings of this type appear to be fairly low mainly as a result of the downtown location and more limited availability coupled with the speculation and new plans for the former hospital when vacancies become available; however, the Kerrville office market was somewhat sluggish to absorb the vacancies." Appraisal methods failed to accurately model 2013-2014 commercial market conditions for Kerrville and Kerr County; rental rates were consistent over the past ten years; significant vacancies existed for rental properties; sales and asking prices had been flat over the past ten years; and data used to calculate replacement costs was not current and was significantly flawed. He requested that commercial properties be reappraised using a method that was consistent, fair, equitable and accurately reflected local economic conditions. A market analysis should reflect market supply and demand and be based on current market activities including sales of commercial property, new construction, new leases, lease rates, absorption rates, vacancies, allowable expenses inclusive of replacement reserves, expense ratio trends, and capitalization rates.

Mr. Parton compared a strip center in Round Rock, Texas to the center at 819 Water Street and opined that KCAD was appraising local values at higher value than the market would generate.

Mr. Coates noted the State Comptroller's Office prepared property value studies every other year as the values affect state funding for local school districts. He presented the property value study of the city as prepared by the state comptroller from 2007-2013 and noted commercial property was undervalued in the past; the median level for commercial property had not been appraised at 100% ratio since 2007. The current commercial value study prepared by the State Comptroller's Office indicated that in 2013 commercial property was at

95.72% and in 2014 the weighted mean ratio for commercial property was 91.18% (all), 84.72% (city), and 80.59% (downtown), which was 19.5% low. The ratio of appraised sq. ft. was 86.67% (all) 79.0% (city), and 76.89% (downtown).

Mr. Folmer noted the CPI and economic indicators mentioned by the city were not part of the appraisal process. The challenge had to be based on the level of appraisal; the percentage in relation to the 100% of that category; or the appraised property assessment evaluation. The state dictated the uniform appraisal measures such as established by International Association of Assessing Officers Standards, which states in Standard 6, Mass Appraisals, that the measure of appraisal level was calculated statistically measuring the central tendency, which described the typical level of appraisals by single number of statistics which would be either the mean, median, or weighted mean; Texas uses the weighted mean.

Mr. Folmer, compared the sales price/appraised price of commercial properties in Kerr County: \$86.12 sq.ft./\$72.05/sq.ft. (all); \$92.68/\$73.15 sq.ft. (city); \$73.65 sq.ft./\$56.63 sq.ft. (downtown). The ratio of selling price to appraised price for commercial property was 86.67% (all); 79.0% (in city); and 76.89% (downtown). He compared current listings of 50 commercial properties and KCAD appraisals were still low. A comparison of the appraised value of residential property to commercial property indicated residential at 99.93% and commercial property at 94.08% (all); 84.13% (in city); 81.11% (downtown). Sales were not increasing but were declining; only one property was valued at or above 100%. He also noted that the downtown area was comprised of about 82-100 properties; only 16 were under protest. The economic indicators used by the city may be correct but where was the market? If a reappraisal was done, where would appraisals go?

Mr. Zigler noted the Property Tax Code mandated that property be appraised at market value, which was 100%, and to be fair and equitable. M&S is a standardize schedule based on standard characteristics such as type of building, square footage, category, and construction style, etc. The city said M&S did not represent city properties fairly because the modifiers were calculated for San Antonio; M&S was a national replacement schedule, which used the San Antonio factor and the sales from the Kerrville area. Property sales information is not readily available in Texas because of privacy laws; however, they used information they could get and then calculated in a local factor designed specifically for KCAD. There were three approaches to appraise values: 1) income received on commercial property; 2) market-based, used when information on all variables and variations was available on many sales; and 3) cost, which was the most effective, consistent, fairest, and equitable method to appraise commercial property. He further stated that every year stands independent of other years; one year does not affect another year. It was illegal to make a deal on next year's value and such would result in a fine. In his opinion, KCAD appraisals were approaching market value, but had not surpassed market value.

Mr. Coates asked the ARB to look at the ratio studies and hard data presented, the value studies prepared by the comptroller, and the standards that governed KCAD. He noted that he had never seen a challenge petition from a taxing entity, but he understood the city's concerns, but he did not feel like KCAD was treating downtown unfairly; KCAD was trying to treat all taxpayers and all categories of property fairly and equitably. Several representatives of taxing entities were present at the meeting, and they were concerned because they had tax rates to set and deadlines; he wanted to move forward and certify the values and get entities their rolls so they could set tax rates and budgets. The data presented was accurate and the ARB should move forward.

Mr. Folmer noted individuals should follow the process established under the law to protest their appraisals to KCAD and then to the ARB; none of the downtown property owners had gone through that process; he encouraged the ARB to support the process in place.

Mr. Stork noted the information presented by the city did not show any sales of commercial property in several years; he asked where the sales came from that were used in KCAD's sales rate. Mr. Folmer responded that sales came from about 50 commercial properties that sold in the county since 2010; the majority of commercial property was in the city. The property for sale listing was not used; however, it was an indication of what the property could bring.

Mr. Parton understood the MLS (Multiple Listing Service) was used as a gauge of what the property value could be; however, KCAD did not consider how many days the property was on the market. MLS stated what the seller wanted for the property and not the actual purchase price; therefore, MLS was not an accurate reflection of economic conditions and should not be used to establish value. KCAD representatives had identified the process used for mass appraisals and using M&S as the basis to create a benchmark for local economy; however, they did not consider the large number of vacancies in rental property and the inventory of undeveloped property on the market. MLS was not an accurate reflection of value, and M&S was difficult to apply to a local economy.

Mr. Coates noted KCAD was not using MLS to appraise; KCAD was using sales. Mr. Folmer noted that some commercial sales were 50% higher than what KCAD had appraised. The ratio study was based on actual sales; however listings were used as an indication of the overall value; it was not used to calculate anything; KCAD appraisals were way under the asking prices. The ratios shown on percentages were not used at all.

Mr. Parton noted there had been discussion that part of the reappraisals this year calculated replacement cost for improvements and next year could see reappraisal of land values; could there be more significant increases in future years?

Mr. Zigler noted his contract with KCAD was a two year contract in order to spread out the cost in an effort to reduce the impact on KCAD. The appraisal was for the value of land today; he did not know what would happen next year. There was land that was under appraised and KCAD needed to finish the process and review sales data and ratios. The appraisals were still under appraised and short of state mandates. Eagle needed to complete the process.

Mayor Pratt noted that KCAD agreed with some of the city's comments and KCAD had not nullified information in the city's presentation with any preponderance of the evidence, and he asked the ARB to render the city's desired result that commercial properties be reappraised using a method that was consistent, fair, and equitable and accurately reflected local economic conditions.

Mr. Zigler opined that the information the city presented was based on emotion and that there had been an excessive raise in value. The city never stated appraisals were above market value; there might have been one sale that was over market value compared to the appraisal. The 12-15 used by the city were still below market value; appraisal versus sales price was still below. The standards and data used were good economic indicators, but were not good for appraisals; information presented by KCAD was conclusive and accurate.

Mr. Morse asked where it was stated that the cost approach was the best approach to use. Mr. Zigler responded manuals and IAAO standards; in absence of excessive number of sales or income figures on property, the cost approach was the most adequate and accurate way to reach value; when there were not enough sales, the cost approach was the standard used to appraise property.

Mr. Torti closed the evidence session. The ARB was limited to looking at the level of appraisal ratios and a preponderance of the evidence that either the appraisal ratios of the representative properties in the challenged category were not correct in order to rule in favor of the city, or reversely to rule in favor of KCAD.

ARB's review of city's evidence:

Mr. Higbie noted the city's values were significantly higher. The value is where the market is today, it did not matter what it was yesterday. Economic growth was not relevant. The city showed 14 properties, only three of those were over 100%; the median was 93%.

Mr. Morse stated that one sale did not make a market and cost did not make value. Austin was the No. 1 real estate market in the country; San Antonio was No. 2; Kerrville was not No. 3. The difference in sales was bothersome; he wanted to adjust it from M&S but did not know how it could be done. He noted there was no demand; should also consider quality and quantity.

Mr. Whittier noted five issues were presented by the city, but only No. 2. applied to appraisals. The city agreed that the methodology used by M&S was not the correct tool to use, but the city did not offer any other methodology that would be more fair and equitable.

Mr. Rich noted the city's data showed that most sales were above the appraised values; if the city challenged, then commercial properties could be reappraised.

Mr. Torti the city made a compelling report on sales, particularly of the 14 sales, some were pre-dated; the city's point was that there was not a market; only 7 sales from 1999 to 2006; 6 sales in 2008 to 2011; and only one sale in 2014. The lack of local commercial property sales and excess supply of commercial property were key things presented by the city.

ARB's review of KCAD's evidence:

Mr. Whittier understood that the challenge was to validate or invalidate the level of appraisals of commercial property in the city and specifically in downtown. The ratios appeared to be at or below 100%, which was the standard that the appraisal district had to meet; if anything, the err was on the side of lower than the 100%.

Mr. Rich noted appraisals were below market and the charge by statute was to be at market; ratio study showed that appraisals were not at that level.

Mr. Higbie noted the method used in appraisal of property was one of the methods required by law, and there was a local modifier factored into the equation. The appraisal district presented over 50 sales, all were recent 2014 sales; that was more sales than presented by the city.

Mr. Torti noted the consultant noted that the cost approach was used but thought there was a lack of sales; the ARB had to look at the level of appraisal ratio.

Mr. Rich noted some properties could be unequal, the data presented was fair and equitable, which is what the ARB was challenged to determine.

Mr. Rich moved that the ARB comply with the appraisal district's figures; to sustain commercial values as issued by KCAD. Mr. Higbie seconded the motion and the motion passed 3-2 with Messrs. Rich, Higbie, and Whittier voting in favor of the motion and Messrs. Morse and Torti voting against the motion.

The meeting adjourned at 3:34 p.m.

APPROVED: 08/12/14

ATTEST:

/s/

Brenda G. Craig, City Secretary

/s/

Jack Pratt, Jr., Mayor