STATE OF DELAWARE

November 26, 2008

The Honorable Ruth Ann Minner
Governor
Tatnall Building
150 William Penn Street
Dover, DE 19901

The Honorable Members of the 144th General Assembly
Legislative Hall
411 Legislative Avenue
Dover, DE 19901

Dear Governor Minner and Members of the 144th General Assembly:

Please find enclosed the final report of the committee formed by House Joint Resolution 22, which directed our offices to supply "recommendations to provide a mechanism for a fair and equitable reassessment of all real property within the State." This report details a framework for reassessment that balances the needs of all involved stakeholders while bringing Delaware in line with the professional standards of the assessment industry.

The committee developed this framework after consulting assessment professionals in other states, researching and reviewing the industry's best practices and meeting with stakeholders to gather information on needs and to discuss implementation concerns. Consensus was quickly reached that maintaining county independence while simultaneously increasing State oversight was desirable. The structure of our recommended system achieves that goal through the creation of a single statewide property database that will be populated and maintained by the counties and administered by the State. Development of a single database will also capture cost efficiencies at a time when government resources are at a premium.

While this report details a fairly comprehensive structure, the committee left some policy decisions unresolved. These issues will need to be addressed if legislative action is pursued. Additionally, the lack of timely reassessment has impacted other areas that were outside of the scope of the House Joint Resolution 22, namely School Equalization funding that might also be addressed if this effort is undertaken. Nevertheless, when presented with the report's general findings, representatives from both the real estate industry and local government commended the committee's work and indicated a willingness to pursue the goals outlined therein.

Thank you for the opportunity to present recommendations on this important topic.

Sincerely,

Michael S. Jackson, Acting Director
Office of Management and Budget

Russell T. Larson
Controller General

Valerie A. Woodruff, Secretary
Department of Education

Richard S. Cordrey, Secretary
Department of Finance

Attachment

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EXECUTIVE SUMMARY

Background: Property reassessment is a common topic among Delaware policy makers. The lack of regular and consistent valuation of property is seen as the cause of many problems and undergoing reassessment is heralded as a solution to many more. House Joint Resolution 22 recognized these issues and asked for recommendations on how best to undertake a statewide process of reassessment.

General Structure: The committee charged with developing these recommendations approached the task by looking at previous efforts in Delaware and other states that have gone through similar processes. The 1995 report and subsequent legislation of the Assessment Practice Review Committee served as the foundation for our analysis. The committee quickly saw that most efforts fell into one of two categories- complete state control or local implementation. There are technical and political benefits and drawbacks to each method so the committee attempted to strike a balance that both followed best practices set by the assessment industry and minimized disruption to existing entities.

Implementation: The committee recommends that the State take on the role of implementing a comprehensive statewide reassessment of all property. A State Assessment Board would be created with representation from the Governor, General Assembly, Counties and practitioners to manage and oversee the initial implementation. The State would issue a single Request for Proposal (RFP) and contract with a vendor to develop one property assessment system that would be used statewide by all jurisdictions. This would provide uniformity among the counties and make statewide analysis simpler.

Assessment Practices: All properties would be assessed at 100% of market value with annual revaluations. Commercial properties would be valued according to methodology recommended by the Uniform Standards of Professional Appraisal Practice (USPAP). All properties would be physically inspected at least once every nine years.[1] The initial reassessment would allow for a three year phase in period for primary residences experiencing steep increases. Additionally, a homestead provision would be implemented limiting the annual increase to a primary residence to 10% after the initial phase in. Excluding growth in the assessment base due to new construction, in the aggregate, County and local governments and school districts would be limited to a 7.5% increase in revenue as a result of the initial reassessment. Overall revenue growth resulting from subsequent revaluations would be limited to 5%.

Responsibility / Accountability: Counties and municipalities would maintain responsibility for data collection and conducting the assessments and all Assessors would be required to become licensed by the State within 5 years. During the initial reassessment, counties would work in

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[1] The committee offered a nine-year cycle for consideration, but recognized that, ultimately, the frequency may be different depending upon the best practices identified by nationally recognized organizations. For example, the International Association of Assessing Officers (IAAO) statement on this topic specifies that:

> "Sales comparison models permit annual reassessment at comparatively little incremental cost. If an accurate database and ongoing maintenance procedures are in place, property inspections can be spread over three to six years, depending on budgetary and other considerations. The sales comparison approach requires less detailed property characteristics data than the cost approach."

cooperation with the State vendor to conduct the valuations consistent with the Uniform Standards of Professional Appraisal Practice. The new property tax database would be administered and monitored by the State Assessment Board with staffing help as needed from DTI, OMB and the Department of Finance. The State Board will also be given enforcement powers by tying county governments' full receipt of the Realty Transfer tax to local compliance in maintaining the assessment information.

Financing: Each county would be responsible to pay for its share of the reassessment and would be allowed to levy an explicitly identified State-mandated supplemental property tax rate to raise the revenues needed to offset the reassessment's cost.

Possible Next Steps: This framework has been shared with representatives from the State's county and municipal governments as well as with representatives of the real estate industry. While it is true that in neither case did the local government or the real estate representatives offer an "official endorsement" of the proposal, in both cases it can be fairly stated that these groups recognized:

1. The practical need for a better functioning property assessment system in Delaware, and

2. That this report's proposals represent a sound foundation for the development of a more refined blueprint for a new assessment system and, ultimately, the legislation that would accomplish just that.

With this in mind, the representatives from both the real estate industry and the State's local government expressed the willingness and desire to pursue the goals expressed in this report.

INTRODUCTION

House Joint Resolution 22 was passed by the 144th General Assembly charging various executive and legislative agencies with "developing recommendations for the reassessment of real property for the purpose of ad valorem taxation by county governments and school districts." Additionally, these recommendations should "provide a mechanism for a fair and equitable reassessment of all real property within the State."

Surpassed in Delaware by only the personal income tax and corporate franchise tax, property taxes are a vital source of government revenues. Proper administration of this tax is critical to efficient and effective government operations. The issue of property reassessment has been a topic among Delaware policymakers since the last assessment was conducted in 1986 in Kent County. Numerous attempts to address this issue have been made while none have been successful. Property assessments in Delaware are anywhere from 22 to 34 years old. The current industry standard is to evaluate the actual market value of properties at least once every six years. Not conforming to these standards creates many equity issues throughout the State and could potentially be a violation of the Uniformity Clause under Article VIII, § 1 of the Delaware Constitution.

The lack of regular and timely valuation of property has many undesirable consequences. Many properties that were given the same valuation in the last assessment have substantially different market values today. Since no reassessment has taken place, many properties are assessed at rates as low as 6% of market value. This means that a home with a market value of $1 million would have an assessed value of just $60,000. Because assessments have not kept pace with increases in market values, Delaware's statewide assessed valuation represents just 21% of the market value ($23.5 billion vs. $110 billion).

In addition to the equity concerns raised by this issue, school financing has also been affected by the lack of regular reassessment. Both local tax revenues and State Equalization funding are linked to property values and have been impacted. With no growth or changes occurring in property assessments, local school districts must rely on new property development or local referendum to realize an increase in local revenue. Additionally, Equalization funding calculations must rely on a complicated sales to assessment ratio study to attempt to capture the changes that regular reassessment would capture.

Commercial interests in Delaware have also felt the affects of outdated property assessments. Businesses such as Verizon and DuPont have successfully challenged their assessments throughout the State based on the lack of comparable technology on which to assess the property. Updating property assessments statewide will help ease the number of appeals to local assessment boards and provide the counties with more accurate property data.

While providing recommendations on some of these related issues is outside of the scope of this committee, addressing reassessment will provide a much more stable and equitable foundation on which to make future policy decisions.

METHODOLOGY

The committee attempted to identify the wide array of key issues that any property tax reassessment plan must address. As a means of organizing these issues, it relied heavily on past efforts to modernize the State's approach to property assessments and, in particular, Senate Bill 217 from the 138th General Assembly.

The committee considered three approaches. In terms of fundamental assessment practices, the three approaches were very similar. All three approaches, for example, embraced the adoption of 100% valuation, regular revaluation, and limits on revenue increases resulting from reassessments. The chief difference between these approaches was the division of responsibilities between the State and its local governments:

1. Limited State Role: Modeled on SB 217, with this approach, the State would set new standards for assessment practices. County governments would be responsible for the design, implementation and operation of the new system. The State would monitor the counties to ensure that they are in compliance with the new standards.

2. Full State Control: Under this model, the State would set new assessment standards for assessment practices. It would also assume all responsibilities for the design, implementation, and operation of the new system. County and municipal assessors would become State employees.

3. Hybrid Approach: Under this approach, the State would set the new standards for assessment practices. Three separate county property tax databases would be replaced by a single statewide database to be housed in and administered by the State. Using a private contractor, the State would assist the counties in the implementation of the new system. A State Assessment Practices Board would be formed to oversee implementation. Once implemented, the counties would be responsible for subsequent revaluations and physical inspections. The State would monitor the counties to ensure that they are in compliance with the new standards.

The committee concluded that the hybrid approach was the most desirable and practical approach. Because the State, instead of each county, would issue a single RFP and develop a single property database, the high costs of implementation would be minimized. Operationally, the hybrid approach avoids the administrative complexities and likely political opposition inherent in the full State control model that would see county employees moving to the State payroll.

EVALUATION CRITERIA

The following presentation of issues is intended to form a framework of analysis that will ultimately allow the Governor and members of the General Assembly to evaluate reassessment clearly and efficiently. While the list of issues is intended to be complete enough to form the blueprint draft legislation, the committee recognizes that this list of issues may not be comprehensive. Moreover, it recognizes that, in the instances in which it has expressed clear preferences, these preferences need to be vetted by the counties and other interested parties.

Standard of Assessment: Properties in Delaware would be assessed according to the Uniform Standards of Professional Appraisal Practice, as promulgated and updated by the Appraisal Foundation. These assessment practices are:

1. National (international) standards for property assessments,
2. Recognized and accepted by professionals and academics as "best practices" and
3. The standard employed by state and local governments across the county to perform accurate and timely property assessments.

Definition of Value (for Income Producing Properties): The committee recommends that valuing income producing property is consistent with the Uniform Standards of Professional Appraisal Practice (USPAP), which, among other objectives, specifies the following goals for discounted cash flow (DCF) analysis:

- DCF analysis is an additional tool available to the appraiser and is best applied in developing value opinions in the context of one or more other approaches.
- It is the responsibility of the appraiser to ensure that the controlling input is consistent with market evidence and prevailing market attitudes.
- Market value DCF analyses should be supported by market-derived data, and the assumptions should be both market- and property-specific.
- DCF accounts for and reflects those items and forces that affect the revenue, expenses, and ultimate earning capacity of real estate and represents a forecast of events that would be considered likely within a specific market.[2]

Assessment Base: Property would be assessed at 100% of market value.

Execution of Initial Reassessment: The committee identified the following implementation steps:

1. Develop a State RFP requesting professional assistance from a private contractor in the design and implementation of a property tax assessment system. The contractor's role would include:
    a. Establishing a single statewide real property database and system to be administered by the State of Delaware,
    b. Training county and state personnel in the systems' use,
    c. Training and assisting county personnel on the conduct of the reassessment itself, and

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[2] USPAP 2008–2009, STATEMENT ON APPRAISAL STANDARDS NO. 2 (SMT-2); SUBJECT: Discounted Cash Flow Analysis.
http://commerce.appraisalfoundation.org/html/USPAP2008/USPAP_folder/statements/CONCLUSIONS_SMT_2_.htm

d. Ensuring that all technical specifications and methodologies were made available to the State upon completion of the work.

2. The State Assessment Practices Board, with the contractor's assistance, would oversee implementation.

3. The counties would be responsible for the physical inspection of properties, data collection, and populating the new database.

Scope and Means of State Oversight: A State Assessment Practices Board would be constituted shortly after the enactment of the enabling legislation. The Board would consist of 9 members, with slots filled by the Governor, counties and the General Assembly. Serving part-time, the Board, working in conjunction with local governments, other State officials and staff and the contractor, would manage the implementation process.

Initial Reassessment's Base Year for Valuation: CY 2012, assuming enabling legislation is passed no later than June 30, 2009.

Effective Date for Initial Reassessment: July 1, 2013 (FY 2014)

Subsequent Revaluations: All properties' assessed valuations would be adjusted annually. The committee considered a three-year cycle, with 1/3 of all properties being revalued in any given year, but expressed a clear preference for annual revaluations.

Physical Inspection Cycle: The committee considered a nine-year cycle ($1/9^{th}$ properties per year) assuming, of course, that it is consistent with the guidelines established by the International Association of Assessing Officers.[3] The group also contemplated a different and perhaps more frequent cycle for commercial / industrial properties.

Cap on <u>Aggregate Revenue Collected</u> as a Result of the <u>Initial</u> Reassessment: The committee recognized the need for limits on the amount county and school revenues could grow as a result of the initial reassessment. While the level of these limits is a somewhat subjective issue, the committee thought that limiting aggregate local government and school tax growth to no more than 7.5% was a reasonable starting point for discussion. Revenues required to fund the initial reassessment's costs incurred by local governments would be excluded from the cap. The 7.5% limit would not apply to the expansion of the tax base as the result of new construction. Subsequent revaluations would be capped at 5% revenue growth excluding assessment growth.

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3 The committee offered a nine-year cycle for consideration, but recognized that, ultimately, the frequency may be different depending upon the best practices identified by nationally recognized organizations. For example, the International Association of Assessing Officers (IAAO) statement on this topic specifies that:

"Sales comparison models permit annual reassessment at comparatively little incremental cost. If an accurate database and ongoing maintenance procedures are in place, property inspections can be spread over three to six years, depending on budgetary and other considerations. The sales comparison approach requires less detailed property characteristics data than the cost approach."

Limitation on Increases in Individual Property Owners' Effective Tax Rates as a Result of the Initial Reassessment: For residential property owners experiencing sharp increases in the tax bills on their primary residences, a three-year phase-in to the updated assessed value would be permitted. The committee discussed different phase-in provisions for commercial and industrial properties, but did not come to a conclusion regarding this issue.

Mechanics of the Cap on Aggregate Revenue Collected as a Result of the Initial Reassessment: (1) Property tax base is reassessed yielding, presumably, much higher valuations, (2) A "rolled-back" rate is established, which when applied to the reassessed base, would produce a revenue neutral result, (3) The local government or school district may propose to increase the rolled-back rate by no more than the amount of the cap. For example:

Old System
- Market Value of Property Tax Base: $2 billion
- Assessed Value of Property Tax Base: $1 billion
- Statutory Rate: 2.0%
- Tax Revenue: $20 million

New System
- Market Value of Property Tax Base: $2 billion
- Assessed Value of Property Tax Base: $2 billion
- Tax Revenue Under Old System: $20 million
- Rolled-back Rate: 1.0% ($20 million / $2 billion)
- Revenue Cap: 7.5%
- Maximum New Tax Rate: 1.075% (1% x 1.075)

Should a local government or school district want to increase revenue collections in conjunction with the initial reassessment, it would be required to provide general notice of the planned increase and announce the date, time and place at which the planned revenue increase would be considered.

Appeals Process: The committee did not reject the idea of maintaining the current appeals process, which consists of appeals being heard first by the County Board of Assessment and then, if necessary, appealed to Superior Court. The group did, however, wish to explore the feasibility of adding a State Property Tax Court that could hear appeals from the County Boards. This Tax Court could help ease the burden on the Superior Court In either case, in anticipation of the large number of appeals originating from the initial reassessment, longer appeal periods would be available.

Ongoing State Operational Responsibilities: The State would be responsible for maintaining the single statewide property database. The State Board would monitor counties' assessment practices and performance and, if necessary, initiate remedial actions against counties that fail to meet accepted standards.

State Staffing: The Office of Management and Budget, Department of Technology and Information, Department of Finance and perhaps other agencies would provide support to the State Board making use of their current complement of employees.

Compliance Standards: The Board would employ the standard developed by the International Association of Assessing Officers (IAAO).

Licensing and Certification of Staff: All assessors employed by local governments must be licensed by the State Board within five years. All contractor assessors hired by local governments must be approved / licensed by the State Board.

Enforcement Provisions: In the event that the State Board determines that a county is not in compliance with accepted standards and procedures, it would initiate remedial action in the form of a partial or complete "hold-back" of Realty Transfer Tax (RTT) revenues. The committee discussed two approaches. The first would call upon the General Assembly to act upon the Board's recommendation to hold back the RTT revenues. Under the second approach, the State's RTT statute would be amended to specify that only those counties in compliance with the State Board's standards are entitled to levy the full amount of the tax.

Financing the Initial Reassessment: Depending upon cash flow requirements, financing could be either in the form of: (1) the State's issuance of debt coupled with a contractual responsibility from each county to pay their respective share of the debt service (essentially the same arrangement between the State and school districts) or a straightforward add on to the property tax bill specifically identifying a State imposed charge for reassessment expenses.

CONCLUSION

Performing a statewide reassessment presents a wide array of logistical, political and financial challenges. This report organizes those challenges in such a way that it can serve as the foundation for the concentrated effort that would be required to replace the current patchwork approach to property assessment with a uniform system that continually and accurately updates property values. The working group responsible for this report's preparation has apprised both local government officials and representatives from the real estate industry on the report's organization of a reassessment's key evaluation criteria and of the general strategies for the implementation and operation of the resulting assessment system. While it is true that in neither case did the local government or the real estate representatives offer an "official endorsement" of the proposal, in both cases it can be fairly stated that these groups recognized:

1. The practical need for a better functioning property assessment system in Delaware, and

2. That this report's proposals represent a sound foundation for the development of a more refined blueprint for a new assessment system and, ultimately, the legislation that would accomplish just that.

With this in mind, the representatives from both the real estate industry and the State's local government expressed the willingness and desire to pursue the goals expressed in this report.

Undertaking a statewide reassessment will not only restore the integrity and equity to the property tax base, it allows for administrative efficiencies to be realized. By adopting a hybrid approach to implementation and undergoing one RFP process and standardizing the database used to warehouse the information, the State ensures uniformity among the counties and a simplified method of collecting and analyzing data for statewide purposes while keeping land use and zoning functions at the local jurisdiction level.

This proposal also recommends establishing and enforcing the annual revaluations of property. By establishing a rolling cycle and taking over enforcement abilities, the State ensures the current situation of outdated assessments does not reoccur and provides a stable revenue source for local governments and school districts. Establishing a homestead provision and allowing an initial phase-in will help mitigate any steep increases that may cause hardship for homeowners while still restoring integrity to the administration of the property tax.