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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

AUG 1 3 1978 089550

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Mr. Emmett J. Rice
Chairman, Tax Revision Commission
District of Columbia

Dear Mr. Rice:

The enclosure provides information on the District's policies and procedures for administering its real property tax and some significant developments concerning the tax in the last few years. The information was gathered during our recent survey of the District's administration of the tax.

We noted that the principle criticisms of the real property tax are that it is regressive and very difficult to administer uniformly, and that it is a disincentive to new construction and rehabilitation of existing structures.

It appears to us that the City Council's establishment of a Tax Revision Commission of diverse composition, provides an excellent (and perhaps unique) opportunity to give the criticisms of the real property tax a thorough evaluation. Officials of the District's Department of Finance and Revenue stated that such a study could prove beneficial.

We are raising for the Commission's consideration the issue concerning the desirability of a fundamental change in the real property tax. We mention some of the changes in the tax that the Commission might consider, e.g. placing the tax on land alone rather than on land and improvements. No conclusions are drawn or intended on either the need for or direction of reform.

The Executive Director of the Commission informed us that the Commission plans to evaluate property tax issues including the land vs. improvements issue, and that the Commission would appreciate receiving any information we could provide. If we can be of any further

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assistance to the Commission in its review of this or any of the other District tax programs, please feel free to call on us.

Copies of this report are being sent to the Mayor, City Council, Office of Budget and Management Systems, D.C. Auditor, Office of Municipal Audit and Inspection, and the Department of Finance and Revenue.

We would appreciate being informed of any action the Commission takes on the matter discussed in this report.

Sincerely yours,

Frank Medico
Assistant Director

Enclosure

ENCLOSURE

GENERAL ACCOUNTING OFFICE
SURVEY OF THE REAL PROPERTY TAX
DISTRICT OF COLUMBIA GOVERNMENT

ISSUE: IS FURTHER REFORM OF THE REAL PROPERTY TAX NEEDED?

Individuals or families occupying residential property in the District, whether as homeowners or renters, pay real property tax. The homeowner pays it to the District directly or through a mortgage holder, while the renter pays it in the rent the landlord charges (some part of which would go to the District for the tax).

Criticisms we noted of a tax on real estate as administered in its basic form are that:

--it is assessed on property value and does not take into account the ability to pay as measured by current money income of taxpayers,

--it tends to be a general disincentive to improve the quality and quantity of housing and other structures, and

--it involves in the valuation process subjective judgments that make it very difficult to insure equal treatment of property owners.

In 1968, a consultant[1/] who had studied the financing of the District Government characterized the tax as follows:

"* * * this is not the best kind of tax, not even a fair one. Its faults--the fact that it ignores taxpaying ability and the cost of supplying different properties with municipal services, that it affects business costs haphazardly, that it poses endless problems for tax administrators--are universally acknowledged and need no elucidation."

The trend nationally has been toward granting lower income homeowners and renters relief from property taxes that cause a financial hardship. The District has joined this trend with a program of tax credits for homeowners and renters having annual incomes of less than $7,000.

1/ L. L. Ecker-Racz: "Financing the District of Columbia." A report prepared for the Government of the District of Columbia, August 30, 1968.

Also, by statute the District permits payment of some tax increases to be deferred, and is considering tax incentives for new construction and improvement of existing structures.

As an alternative to property tax relief programs, the District should consider whether it would be practicable to change the basis for the tax to overcome the criticisms of it and make tax relief unnecessary. Tax relief measures generally complicate tax administration and may tend to cloud the taxpayer's understanding of the tax. Reform, therefore, also should result in a tax which is less difficult to administer and understand.

Some of the possibilities for revising the tax would be (1) removal of buildings from the base so that the tax applies only to land, (2) taxing buildings at a lower rate or on a different base than land, or (3) transforming the tax into a service charge based on the recovery of the cost of municipal services (police, fire protection, etc.) provided different classes of property owners.

These possibilities for revising the real property tax would require careful study. In studying them, some basic questions about the tax should arise from the District's point of view. For example, is the property tax a rational basis for raising District revenue? Do the burdens it imposes on individual and business property owners bear any relationship to the value of city services provided various classes of property? Should there be some such relationship? What would be the effects on the value and use of land if land improvements were not taxed or if they were taxed at a lower rate or on a different base than the tax on land?

These are not easy questions to answer. Any one of them could probably generate considerable debate among economists and public finance experts. Nevertheless, we believe that the District could benefit from an in-depth review of such questions.

On November 18, 1975, the Council of the District of Columbia created a Tax Revision Commission to analyze the District's present tax system and administration of existing tax laws. The Commission has 20 members drawn from experts in the field of taxation such as tax lawyers and public finance economists; community representatives such as members of labor unions, public interests groups, civic associations, and tenant and housing associations; and representatives of important sectors of the business community such as real estate, banking, retailing and public utilities.

With the existence of the Tax Revision Commission, it would be a good opportunity for the District to closely examine whether the real property tax should be further reformed. We believe that further consideration of this issue is in accordance with the objectives and authority established in the District of Columbia Real Property Tax Revision Act of 1974. (See page 7 .)

Officials of the Department of Finance and Revenue informed us that consideration of further reform of the real property tax could be beneficial to the District.

BACKGROUND DATA

The tax on real property is one of the District's largest single sources of revenue. The term "real property" means real estate identified by plat on the records of the District of Columbia Surveyor according to lot and square together with improvements on the lot.

Revenues derived by the District from the real property tax and their relationships to total tax collections for fiscal years 1969 through 1975 were as follows:

Fiscal Year	Total Taxes Collected	Collected from the Real Property Tax	Percent of Total Tax Collections Derived from the Real Property Tax
1969	$342,571,000	$107,147,000	31.3
1970	392,240,000	113,896,000	29.0
1971	436,554,000	119,624,000	27.4
1972	460,091,000	126,548,000	27.5
1973	505,109,000	135,012,000	26.7
1974	533,283,000	138,374,000	25.9
1975	547,837,000	130,956,000	23.9

The declining percentage of total tax collections derived from the real property tax can be attributed predominantly to the increased revenue-producing role of income and sales taxes.

Real property tax revenues were derived from the following taxed (assessed) values assigned to properties in the District and applicable tax rates for the years shown.

Fiscal Year	Total Taxed Value	Rate Per $100 of Taxed Value
1969	$3,557,240,196	$3.00
1970	3,672,533,933	3.10
1971	3,835,628,959	3.10
1972	3,939,158,591	3.20
1973	4,036,486,514	3.32
1974	4,168,382,183	3.32
1975	3,917,818,449	3.32

As of fiscal year 1975, about 44 percent of District land area and improvements thereon was taxed. Government-owned (Federal and District) properties accounted for about 48 percent of the District's land area and the remaining 8 percent consisted of properties owned by foreign governments and various religious, educational, charitable, and other organizations exempted from taxes.

Administration of the property tax

The responsibility for administering the real estate tax is assigned to the Department of Finance and Revenue (DFR). DFR's Office of Assessment Administration is assigned the responsibility for assessing (determining the value of property) and billing the tax and it is collected by the District Treasury.

During fiscal year 1975, Assessment Administration had 147 positions budgeted at a cost of $2.2 million to assess and bill the property tax. The costs for data processing services and collection of the tax were not available separately.

Scope of survey

We reviewed pertinent sections of the D.C. Code, organization charts, and available policy and procedures documents. We discussed the assessment policies and procedures with officials of the Department of Finance and Revenue. We also reviewed various articles dealing with property tax reform written by individuals recognized as having expertise in taxation and public finance.

CERTAIN ASSESSMENT PROCEDURES CHALLENGED IN COURTS

Increases in level of assessment without public notice

Since 1922, District law has required that all real estate in the District of Columbia subject to taxation, including improvements, be listed and assessed at not less than its full and true (market) value in lawful money.

Available records indicate that sometime prior to February 1956, the District's Board of Commissioners decided that the property tax rate should be applied to 65 percent of market value. Purportedly, at that time assessed values on the role were averaging about 65 percent of market values and the Board believed that the 65 percent standard should be used for new assessments to help insure equal treatment of taxpayers. The District's estimate of market value was based on land values and construction or replacement costs for buildings.

In 1968, comparison of sales prices with assessed values of properties sold showed that market values were rapidly rising and indicated that most residential property in the District was assessed well below 65 percent of market value. Many of the residential neighborhoods showed levels of assessment of less than 50 percent. Most categories of commercial property were assessed at average values closer to the 65 percent standard. The District concluded that market values for residential properties were appreciating so rapidly that the cost method should no longer be used for valuing residential properties. (See page 21 for a discussion of the methods of valuation.)

Therefore, in 1969, the District began using a market data approach as the primary method to estimate the value of residential property. Under this approach, the District values property using sales prices of other properties which are comparable in size, location, and condition. The District estimated that it would take two or more years to revalue all residential properties using market data.

In order to maintain reasonable equalization from year to year and at the same time move toward the 65 percent goal, the District determined that the work program for the assessment review beginning in calendar year 1969 would have as its primary objective bringing all residential property assessments up to 55 percent of estimated market value. The work program beginning in calendar year 1971 was to bring all residential assessments up to 60 percent of estimated market value and the work program beginning in calendar year 1973 was to bring all residential assessments up to 65 percent of the estimated market value.

In June 1973, the District's approach to reach 65 percent assessment values for all residential properties was challenged in the District of Columbia's Superior Court in a class action suit on the basis that it did not comply with Title I, Section 1-1505 (a), District of Columbia Code, which states in part:

> "The Commissioner and Council and each independent agency, shall, prior to the adoption of any rule or the amendment or repeal thereof, publish in the District of Columbia Register * * * notice of the intended action so as to afford interested persons opportunity to submit data and reviews either orally or in writing * * *."

The District's position was that increasing the level of assessment was not a change in policy or the adoption of a new rule, but merely an administrative action to achieve 65 percent assessment values. However, because no notice was published and because this action would affect all property owners in the District, the Court found for the plaintiffs and ordered the use of a 55 percent level of assessment for all residential properties. This order was upheld on appeal.

With the probability of another class action suit by commercial property owners, the District ordered, on January 18, 1974, that a level of assessment of 55 percent be applied to all valuations of real property subject to taxation in the District of Columbia.

"Hot-spot" assessment

Section 47-702 of the D.C. Code states that "Assessments of real estate in the District of Columbia for purposes of taxation shall be made annually..."

DFR was not revaluing all District properties each year. Department officials maintained that with the resources available it was not possible to review the values assigned to 136,000 taxable properties more often than biannually.

DFR adopted criteria for determining which properties would be revalued in a given year. The top priority was given to revaluing properties in those neighborhoods where the difference between sales prices and assessed values were the largest. According to DFR officials this procedure, sometimes referred to as "hot-spotting," was used in many other jurisdictions.

Because the real estate tax is an ad valorem--based on value--tax, DFR maintained that equity in administering the tax was best served if the average of all values assigned to properties for a tax year was as close as practicable to the average of their market values. According to DFR officials, "hot-spotting" helped achieve this objective because it gave priority to neighborhoods in which property values were rapidly rising or falling. They maintained that had this priority not been placed on revaluing properties in such neighborhoods, there could have been a gap of two or more years between their revaluations and the result could have been significant differences between the values used to tax the properties and their true market values.

The "hot-spotting" procedure also was challenged in the District's courts and in July 1974 the court ruled that it violated the equal protection and due process clauses of the Constitution. The court ordered those properties revalued for FY 1975 to constitute Group A and those properties not revalued for FY 1975 to constitute Group B. Group B properties would be revalued for FY 1976. Thereafter, if resources permitted, all properties should be revalued each year.

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These two court cases highlighted the difficulty of administering a real property tax and set the stage for property tax legislation in 1974. The implication of the court decisions seemed clear--equitable administration of the real property tax requires that all properties be revalued every year.

DISTRICT OF COLUMBIA
REAL PROPERTY TAX REVISION ACT OF 1974

The District of Columbia Real Property Tax Revision Act of 1974 (P.L. 93-407, September 3, 1974) has the following objectives:

--Equitable sharing of the financial burden of the government of the District of Columbia.

--Full public information regarding assessments and appeal procedures.

--Promotion of economic activity, diversity of land use, and preservation of the character of the District of Columbia.

--Assurance that shifts in the tax burden on individual taxpayers would not be excessive.

--Comparability of tax effort between the District of Columbia and surrounding jurisdictions in the Metropolitan area and cities of comparable size.

The act seeks to improve the assessment and administration of the property tax and create a more progressive and economically useful tax. The key provisions of the act are discussed below.

Tax to be assessed on 100 percent of annual estimate of market value

Public Law 93-407 provides for a better understanding of the base for assessing property taxes by requiring that the assessed (taxed) value for all real property shall be the estimated market value of the property as of January 1 of the year preceding the tax (fiscal) year. For example, for the tax year beginning July 1, 1976 (fiscal year 1977), the tax base should be the estimated market value of property as of January 1, 1976. Depending on the type property involved the estimated market value will be derived using the approaches to value discussed in the appendix.

The act requires that for fiscal year 1978 and for each fiscal year thereafter all real property shall be revalued annually. Therefore, in calendar year 1976, DFR will be required to review the values assigned all properties in the District to establish their taxable (market) values for fiscal year 1978.

To accomplish this mass appraisal of properties on an annual basis, DFR will use computers for making the mathematical computations necessary to help establish estimated market values.

Assessment notices, appeal, and review procedures

Pursuant to P.L. 93-407, the District, in January and February of each year, must notify property owners of the assessed--estimated market--values of their properties for the next fiscal year and provide the owners with explanations of changes in value over the preceding year and the procedures for appealing the new assessments. In this notification, property owners also [illegible] be informed of data available to them for evaluating the District's assessment of their properties and the special property tax benefits, incentives, limitations, or credits provided by law.

A property owner who believes that the District's valuation of his property is not fair may appeal to the Board of Equalization and Review for a review of the assessment. The Board of Equalization and Review has 15 members, who are to be persons having knowledge of the valuation of property, real estate transactions, building costs, accounting, finance, or statistics. None of the members may be officers of the District of Columbia Government. Decisions of the Board may be appealed in the Tax Division of the Superior Court of the District of Columbia.

In addition to hearing the appeals of individual property owners, the Board attempts to assure that all real property is assessed at its estimated market value. Based on the record of complaints or of other information available to, or solicited by, the Board, the Board is to raise or lower the estimated market value of any real property which it finds to be more than 5 percent above or below the estimated market value arrived at by the District.

Information available for public inspection

In addition to information on the valuation of his property which a property owner receives in the assessment notice, the notice also will alert him to additional information which is available to the public under P.L. 93-407.

The Act provides that the preliminary assessment roll for the coming fiscal year be made accessible to the public. The preliminary assessment roll is a book compiled in tabular form containing the name of the owner, address, lot and square, amount, description, and value (as of January 1, of that year) of the land and improvements of all real property whether such property is taxable or exempt. The book is to be placed in the District's main public library and at such other points as may be determined by the Mayor. (There will be a copy of the roll at a library in each of eight wards of the city as well as at the Municipal Center and the District Building.) This increased availability is to enable taxpayers to more conveniently make assessment comparisons.

Also, all data that have aided the District in deriving a value for a particular property are to be made available to the taxpayer. Such data includes maps, field books, assessment-sales ratio studies, surveys, plats, and any notes and memorandums relating to the assessment of real property or a statement clearly indicating the basis upon which property has been assessed. Procedures were being developed to make this information easily and quickly accessible.

Tax relief provisions

Because the real estate tax in most jurisdictions is levied at a flat rate (the same tax rate is applied to all properties) on property values, it is often criticized as a regressive tax; however, this view is not universally accepted. Some economists view the tax if uniformly administered as neither progressive nor regressive while others consider it progressive. The contention of both the latter groups of economists is that the ability to pay property tax should be measured against a criterion broader than current income. According to these economists, the tax, uniformly administered, is neutral if compared to permanent or long-term income of taxpayers, or progressive if compared to the wealth of taxpayers.

The Advisory Commission on Intergovernmental Relations (ACIR) apparently views the property tax as regressive. In a study[1] using 1970 data prepared by the U.S. Bureau of the Census for ACIR, real estate taxes for owner-occupied single family homes in the United States were found to average about 3 percent of family income when such income was $25,000 or more and averaged over 6 percent when family income was less than $5,000. In the Northeast, this regressivity (in terms of current income) was shown to be even more pronounced.

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[1] The Property Tax in a Changing Environment - March 1974. Table B-3, page 260.

A similar type study[1] performed by the District using 1975 data estimated the real estate tax burden at about 5.3 percent for a District family with an income of $5,000. It estimated the burden at about 3.3 percent for a family with an income of $30,000. The District's study estimated the average overall tax burden at about 9.0 percent for a family with an income of $5,000, and 10.2 percent for a family earning $30,000 per year. Therefore, the real estate tax comprised 59 percent of total taxes paid by a family with an income of $5,000 and 32 percent of the taxes paid by a family earning $30,000 per year.

Many jurisdictions have adopted techniques for reducing the burden of the real estate tax, especially at the lower income levels. These techniques include circuit breakers, homeowner exemptions, and tax deferrals.

Circuit breaker

The idea behind the circuit breaker is to prevent real estate taxes from exceeding a percentage of income that the jurisdiciton finds to constitute an extraordinary burden by rebating a part of that tax usually through the individual income tax. Circuit breakers may be extended to renters on the assumption that a portion of rent paid represents real estate tax even though the tax is billed to the owner of the building.

There are two general types of circuit breaker provisions in use today. They provide tax relief to (1) elderly homeowners and renters, or (2) homeowners and renters, regardless of age.

The District's circuit breaker established by P.L. 93-407 provides an income tax credit for property taxes paid by District homeowners and renters with family incomes of less than $7,000. The amount of credit for a given property tax paid declines as income increases. Those eligible District homeowners and renters who are not required to file income tax returns may file a claim for payment of the property tax credit.

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[1] Comparison of Major State and Local Tax Burdens in Selected Washington Metropolitan Area Jurisdictions - 1975. Table II, pp. 4-5.

The District circuit breaker program was estimated to involve $5.5 million in relief payments for calendar year 1975.

Homeowner exemption

The homeowner exemption reduces property tax for homeowners by excluding from the tax computation a part of their properties' values. Public Law 93-407 authorizes the City Council to enact a reduction of up to $3,000 from the taxable value of single family residences whether owner or renter occupied; on row dwellings, detached dwellings; or semi-detached dwellings.

At the fiscal year 1976 tax rate (1.825 per $100 of value), the homeowner exemption would provide a $55 tax reduction for homeowners and renters. Since the District has a property tax circuit breaker for lower income families, the full amount of the homeowner exemption will not be realized by these families. This is due to the circuit breaker being based on property tax liability. A reduction in property tax liability for lower income families by enactment of a homeowner exemption would decrease the tax relief they receive from the circuit breaker.

The following hypothetical example shows what the net tax effect would be of introducing a homeowner exemption on top of the District's current circuit breaker.

EXAMPLE: The taxpayer has $5,000 annual income and the value of his home is $20,000.

	Tax Computation		
	With Circuit Breaker	With Exemption and Circuit Breaker	Total Net Difference
Tax on value (@ 1976 rate of $1.825 per $100)	$365	$365	-
Homeowner's exemption ($3,000 @ $1.825 per $100)	-	55	$55
Net		310	
Circuit breaker (@ $5,000 level)	97	67	(30)
Net Tax	$268	$243	$25

During Council hearings on the property tax in July 1975, the Department of Finance and Revenue recommended that the homeowner exemption not be implemented. The Department said that if additional relief was considered necessary, it favored expanding the circuit breaker. The Department noted that the exemption would mean additional administrative procedures and expense.

Tax deferrals

The device of tax deferral allows a homeowner to defer a portion of his property tax until such time as he is better able to pay the tax or sells the property. The deferred taxes are interest bearing and become immediately payable when the title to the property is changed in any way.

P.L. 93-407 established two tax deferral possibilities for District homeowners. These tax deferrals were provided to minimize any tax increases for homeowners because of the shift to assessing property tax at 100 percent of market value.

Under the program, a taxpayer whose combined household income (adjusted gross income for District income tax purposes) for a year does not exceed $20,000 may defer each year any real property tax increases in excess of 10 percent. A taxpayer whose combined household income on the same basis exceeds $20,000 may defer tax increases in excess of 25 percent. The latter deferral terminates June 30, 1979 unless the City Council extends it.

To receive the benefits of tax deferral a taxpayer must have owned the property for at least five years and use it as his principal place of residence. Also, increases in property taxes attributable to improvements or zoning changes cannot be deferred. The cumulative taxes deferred plus interest (average Treasury bill rate for preceding twelve months compounded annually) cannot exceed 10 percent of the current assessed value of the property.

Tax incentives for rehabilitation
and new construction of building

The effect of real property taxes on decisions involving the construction, modernization, improvement, or demolition of buildings gives rise to a major argument of economists who advocate that the emphasis of the tax should be on land rather than the buildings on it. The views of two economists who advocate this concept are presented below.

> "Progress will come from redesigning property taxation, not to reduce total revenue yield (for needs of local treasuries seem too great), but to get much more from land and much less from structures and other improvements. The change would recognize and build upon the essential difference between land and buildings * * *.
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> "The tens of millions who live in cities and suburbs pay heavily for living and working space. Their demands for room have sent land prices up, and the increasing amounts paid have all too often gone to private owners whose positive contributions toward enhancing the attractiveness of the area have not been correspondingly large.
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> * * * * *
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> "* * * The property tax on buildings hits well-constructed, high-quality structures far more heavily per unit floor space or cubic content than does the tax on slums and 'junk.' The element of property taxation which falls on buildings creates an incentive against upgrading their quality, which is especially undesirable in those parts of older cities having the combination of urgent construction needs and high tax rates. Such discouragement of private effort to raise quality does not come from the tax on land.
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> "Every decision involving the construction, modernization, improvement, or demolition of buildings must be weighed against the tax results. The greater the tax on structures, the fewer the number of investment projects--and the smaller the number of dollars put into each--which will yield a satisfactory after-tax return. Lowering the tax rate would raise the expectations of benefiting from more investment (in quantity and average quality) in housing and other types of buildings."[1]

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[1] C. Lowell Harriss, Professor of Economics at Columbia University and Economic Consultant to the Tax Foundation, Inc. from an article entitled Reforming Property Taxation. This article appeared in the November 1970 Michigan Business Review.

"* * * It is generally agreed that placing the present real estate tax on land alone will stimulate the investment of more funds in buildings. More buildings will be built and they will be built to include a larger number of usable units whether they be dwelling units, offices, stores, or other facilities. The total supply of housing, manufacturing and mercantile building facilities will increase although each category of facilities will not necessarily be increased uniformly.

* * * * *

"* * * The removal of the tax on building values will encourage the rehabilitation and remodeling of buildings which have deteriorated and become obsolete. Remodeling, in some instances, may involve the conversion of buildings to a (higher) use for which there is a greater demand. * * *"[1]

P.L. 93-407 gives wide latitude to the City Council to develop regulations for providing tax incentives for rehabilitation of property and new construction. Two methods are mentioned in the act but the District is not limited to these two approaches. They are (1) to not tax the increased value of new or rehabilitated property for a specified period--for example, five years, and (2) to establish different tax rates for land and improvements. The City Council has not yet developed these regulations.

THE DISTRICT'S VALUATION OF PROPERTY

Assessment areas

To facilitate the valuation of properties in the District of Columbia, the Office of Assessment Administration has divided the city into 72 areas. The boundaries of these areas are established so that to the extent feasible, they contain homogenous properties, generally similar in construction, age and economic influences. Taxable properties are contained in 56 of the areas. The remaining 16 areas have unique characteristics and some consist of only one parcel of land, such as Rock Creek Park, the National Arboretum, or the Mall. These 16 areas are tax exempt. Division of the city into areas facilitates management of the valuation process.

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[1] Arthur P. Becker, Professor of Economics, University of Wisconsin-Milwaukee, "Arguments for Changing the Real Estate Tax to a Land Value Tax"

Classification of properties by use type

Another aid in valuing properties is the classification of properties by use type; that is, according to the purpose for which a property is being used. Residential property is composed of five types--row houses, detached homes, semi-detached homes, flats, and residential garages. Apartments are divided into walkup and those with elevators. Hotels and motels are classified as such, and office buildings are designated as small office buildings and large office buildings. Other commercial property use types are stores, theatres, parking garages, warehouses, banks, filling stations, etc. Exempt property is broken down into such use types as churches and synagogues, hospitals and sanitariums, school buildings, office buildings, embassies, libraries, museums, etc. Vacant land is segregated as taxable and exempt.

Approaches to value

According to the American Institute of Real Estate Appraisers there are three common bases for the valuation of property. They are: (1) Cost Approach--the current cost of reproducing a property minus depreciation from deterioration or functional and economic obsolescence; (2) Income Approach--the value which the property's net earning power will support, based on a capitalization of net income; and (3) Market Data Approach--the value indicated by recent sales of comparable properties in the marketplace.

In valuing property, the Office of Assessment Administration employs these three methods of appraisal recognized by the American Institute of Real Estate Appraisers.

Cost method

The cost method, as employed by the District, is used mainly in the appraisal of new construction of commercial properties. The District obtains information from developers in the District as well as national sources and establishes cost data to be used in estimating the cost of new construction.

In using the cost method, the assessor estimates the cost of replacing a building at the time of his reassessment based on the cost data. Thus as construction prices increase or decrease so will the estimated cost of replacing a building. This replacement cost is then depreciated according to the building's age.

The first appraisal of a property (the building portion) is made when it is "under roof" or weather-tight. At that point in time it is appraised by the cost approach and placed on the records at the percentage that its stage of completion bears to its estimated full value at completion. A comparison may be made with the builder's cost. In cases where there is a large discrepancy between the two figures, an analysis is made of the builder's cost schedule for reconciliation of the two figures. As construction progresses, the property is revalued. The change in value reflects the stage of building completion at time of revaluation. When the building is completed and occupancy has begun, it is again revalued using the income approach.

Income method

Generally the income method is used by the District to value commercial properties.

Information on income and operating expenses is obtained by means of schedules sent to owners of commercial properties that are to be revalued. From this data, the gross incomes of the properties are calculated.

Example: A 100 unit apartment building renting for $150 per unit per month yields $180,000 gross income per year. The building's operating expenses, which may vary considerably depending on the type of business, are subtracted from this amount. In addition to the operating expenses, a vacancy factor and bad debt expense is allowed which also may vary according to the type of business. A vacancy factor will range from 2 to 10 percent for apartments whereas a 40 percent vacancy factor or higher may be allowed for transient accommodations. Two expenses not allowed are mortgage payments and depreciation, since they reflect the owner's investment and are not concerned with the building's value.

In the example below, 54 percent of the gross income is allowed for expenses. According to the senior assessor in charge of valuing apartments and flats, this amount is generally realistic for apartment buildings in the District as determined from expense schedules and is composed of 52 percent for expenses and 2 percent for the vacancy factor.

Example: Total expenses = 52% + 2% = 54%

$180,000 x 54% = $97,200 (expenses)

$180,000 - $97,200 = $82,800 (net income)

The net income is capitalized at the rate of return prevalent in the market at the time of valuation. Just as fluctuation of construction costs may influence the valuation of a property under the cost method, market trends on the rate of return of money invested may influence the valuation of a property under the income method.

The capitalization rate is composed of two interest rates, that generally expected to be received by mortgage holders and that generally expected to be received by the property owners or investors. It is necessary, therefore, to know the percent of money invested in the property by the mortgage holder and by the owner. The District obtains such information from the income and expense schedule sent to the property owner. The amount of return the mortgage holder and property owner expect to receive is determined from the market. For the property owner, his return must be high enough to warrant the risk involved and certainly greater than he could receive by placing his money in a guaranteed savings account or long-term deposit.

The capitalization rate is derived from this information by multiplying the amount of investment by the amount of return for both the mortgage holder and property owner and then summing the products.

Example:	Mortgage:	75% (amount of investment)	
		x 8% (amount or return)	= .060
	plus		
	Equity:	25% (amount of investment)	
		x 10% (amount of return)	= .025
	Capitalization Rate (C. R.)		.085

The market value of the property is established by dividing the net income by the capitalization rate.

Example: $82,000 (net income) ÷ .085 (capitalization rate)

= $964,706 (market value)

Various check points are used to test the results obtained by using information provided by the property owner. For example, we were advised that new apartment buildings usually sell for five or six times the annual gross income derived from the building and the real estate tax averages about 10 percent of the gross income derived from the building, plus or minus 1 percent. Other tests are based upon comparisons of data submitted by property owners in an area to establish a range in which income or expense data should fall. For example, economic rent schedules are developed for an area. These schedules show the gross income from a building broken down into dollars per square foot. Expense schedules are also prepared. They show the expense a building would normally incur considering age, area, and size. These types of schedules are prepared each time properties in a particular area are revalued.

Market Data Approach

The third valuation method used by the District is the market data approach. This method is used on residential properties and commercial properties and is intended to result in the placement of values on properties based upon the sales of properties which are comparable in size, location and condition. This approach is based on the principle that the value of a property tends to be set by the cost of acquisition of an equally desirable substitute property.

Pursuant to the District of Columbia Real Estate Deed Recordation Tax Act, passed in 1962, all transfers of real estate titles and the amount of consideration must be registered with the District. This information, channeled through the Real Estate Assessment Section, is analyzed and sales cards are prepared. The following information is shown on the sales cards: address of property by street number and square and lot; seller and buyer; amount of consideration in total and by costs and trust; current assessment; and the assessment/sales ratio.

These cards are placed into one of two groups, those considered to be "arms-length" transactions and those that are not. Decisions as to which sales are or are not "arms-length" are based upon several factors, such as: knowledge of speculators' names; names of grantors or grantees, such as corporations, companies, and trustees; knowledge of approximate value of properties in the same areas; and a listing of non-usable deed transactions. Non-usable transactions include: transfers to or from the Federal or District government; sales between a corporation and its stockholder, subsidiary or affiliate corporation; transfers of property in exchange for other real estate, stocks, bonds, or other personal property; quit claim deeds; sales to or from any charitable, religious, or benevolent organization; transfers to banks, insurance companies, savings and loans, institutions such as VA, FHA, etc., when transferred in lieu of foreclosure; transfers to foreign governments; sales to the D.C. Redevelopment Land Agency; tax sales; and acquisitions by railroads, pipeline companies, or other public utility corporations for right-of-ways.

Transfers of the foregoing nature are generally excluded, but may be included after an investigation if it appears the transaction was between a willing buyer and willing seller. Because of sufficient transfers that are considered "arms-length" such investigations are usually not needed. After "arms-length" transactions have been selected, the sales prices are adjusted as necessary for the time between the date of sale and the date of the District's valuation of the property.

Comparable sales are then examined to determine the factors and trends which influence value. Appropriate units of comparison, such as price per square foot of building, price per room, and price per apartment unit may be employed by the assessor. The assessor may be required to make adjustments to the comparable sales data based on the factors and trends which influence or affect value. These may include physical and economic conditions, location and time of sale, financing, etc. The adjustments may be expressed on a lump sum or percentage basis and are applied to the sale property, not to the property under review.

Market data thus compiled is then analyzed for application to the valuation process. Included in this information are assessment/sales ratio studies done by property type and class and by area of the city, which would indicate the relationship between current District valuation and recent market activity. The range of values developed by the assesor for property types within areas can then be applied to value all similar properties in the areas.

Land Valuation

The taxed value of land in the District is determined by the site valuation method. Before beginning his revaluation of properties in a given area, the assessor makes a study of land values in that area. These values are established using market data for vacant lots or the land residual approach. Market data involves using sales data to determine the amounts for which similar lots in similar locations will sell. Due to the limited market data on sales of vacant lots, sales several years old and in different locations may be considered if they are for similar size lots. Also, sales of lots having different sizes, shapes, or topographical characteristics in the same location are analyzed. Where reliable sales data on vacant lots does not exist, the assessor accumulates data on recent sales of commercial properties with new improvements, estimates the value (costs of replacement less depreciation) of the improvements and uses the differences as the basis for valuing land in the area.

The District's policy in valuing land is that its highest and best use will be given consideration. This means that in the valuation of a property, consideration should be given to the use that could be made of the land according to the applicable effective zoning. Thus, a single-family dwelling situated on land zoned for commercial use would be valued differently from a similar dwelling situated on land zoned for residential use. The difference would be in the valuation of the land. For the dwelling located on commercially zoned land, a higher proportion of the property's total value would in the land as compared to the same dwelling located on residentially zoned land.