

THE VIRTUOSO

A Newsletter of North Carolina's Candidates' Club

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JOSEPH E. HUNT, EDITOR

CANDIDATES' CLUB COMES OF AGE

1984 was the beginning. In that year the Candidates' Club was formed by the Institute of Government and received national recognition by the International Association of Assessing Officers. The Virtuoso was established as the Club newsletter and regular meetings began, with programs designed to inform and assist club members in obtaining professional designations in assessment administration. The Club used 1985 as a foundation-building year. It established a firm financial footing to ensure its future and changed its name to "North Carolina's Candidates' Club" to identify the State of North Carolina as founder of the first Candidates' Club in what appears will soon be part of the national IAAO professional admissions program. The Club expects to grow and continue to prosper. At this time the North Carolina's Candidates' Club has 119 members and 43 approved candidates in IAAO's professional program. Yes, in its third year, the Candidates' Club is coming of age, and in fostering professional assessment administration in North Carolina, it is taking its place among other professional organizations in the nation.

DON'T FORGET!
CANDIDATES' CLUB MEETING
INSTITUTE OF GOVERNMENT
MAY 29-30, 1986

CANDIDATES' CLUB RECEIVES \$1,000 AND LEVIES \$10 MEMBERSHIP DUES

Recognizing the contribution of the North Carolina Candidates' Club to professional assessment administration, the North Carolina Association of Assessing Officers voted to grant \$1,000 to the Candidates' Club treasury. The money is to be spent as needed to maintain a high level of assistance programs for the professional designation of North Carolina assessment administrators. Earlier club meetings have been subsidized by the Institute of Government so that the Club could provide such knowledgeable speakers as Dean McQuown, Director of IAAO's Professional Designation Program, and Tom Tegarden, CAE, MAI, Chairman of IAAO's Residential Demonstration Report Grading Committee. The motion to make the grant passed unanimously at the NCAAO business meeting on November 15. This gift will enable the Club to continue its high-quality programs without having to wait until a treasury can be built up through dues or other means.

In order to assure continued revenue for club programs, the Club voted to institute a \$10 annual membership fee from each member, beginning January 1, 1986. If all current members continue to participate, dues will provide over \$1,000 per year to the club treasury, which will permit greater flexibility in planning future programs and workshops. If you have any ideas on programs that would be helpful to you in meeting your candidacy requirements, please write Deborah Zane King, Real Property Appraiser, Secretary/Treasurer of NCCC, 9400 Hood Road, Charlotte, NC 28215.

**NEXT CANDIDATES' CLUB MEETING
SET FOR MAY 29-30**

The Candidates' Club will next meet at the Institute of Government on the UNC-Chapel Hill campus on May 29-30. The meeting will begin at 1:00 p.m. on Thursday and end at 12:30 p.m. on Friday.

The Club steering committee will meet at the Institute of Government on Saturday, February 22, between 10:00 a.m. and 2:00 p.m. One purpose of the meeting will be to make arrangements for the May meeting. If you have any suggestions for that meeting or other concerns regarding club operations, please contact one of the steering committee members or attend its meeting this month.

Members of the steering committee are J. D. Brickhouse, Tyrrell County; Dale Campbell, Catawba County; Margaret Claxton, Jackson County; Debbe King, Mecklenburg County; Carl Mericle, Forsyth County; Porter Stokes, Pitt County.

**MAYES APPOINTED IAAO REPRESENTATIVE
FOR STATE**

Jack Mayes, Supervisor of Business Property Assessments, Charlotte-Mecklenburg, has been appointed the 1986 IAAO representative for North Carolina. Mayes was appointed by William Diggs, newly elected president of IAAO.

Jack is excited about this assignment and is looking forward to a productive year for IAAO. He plans to contact all potential members in the state, focusing specifically on regular memberships and memberships in the personal property section. Other areas of concentration will be the promotion of IAAO educational courses and professional designations.

If you have any questions about IAAO memberships, programs, and courses, please contact Jack at (704) 336-3325.

PROPERTY TAX WINDFALLS: GOOD AND BAD
Joseph E. Hunt, MAI, CAE

"Windfall," as used here, is a word used to describe an unexpected advantage or profit that suddenly accrues to the value of real estate. This benefit is realized by the individual real property owner and is usually considered to result from circumstance and not entrepreneurial endeavor. The latter--entrepreneurial profit--usually results from real estate development, while windfall is defined as "an unexpected or sudden gain or advantage."¹ Entrepreneurial profit is defined as "a market-derived figure that represents the amount an entrepreneur expects to receive in addition to costs; the difference between total cost and market value."² Both terms, by definition, indicate a positive result; but for the purpose of this discussion, such a result is not to be assumed. The unexpected result can be good or bad--producing either profit or loss. For present purposes, then, windfall is a sudden and unexpected change in property value that does not result from actions by the owner--a windfall profit or a windfall loss. Many factors can produce windfalls, either profit or loss, to property--including sudden changes in the property tax system.

Windfall profit can derive from either direct or indirect causes. Direct causes are changes to the property itself, and indirect causes are changes to properties or neighborhood that increase the value of adjacent property.

Indirect windfall profit usually stems from public works projects: An interstate highway is constructed, and the farm that it splits in two--once with little access to the city--becomes a

1. Webster's New Collegiate Dictionary (Boston, Massachusetts: G. & C. Merriam Company, 1982), p. 1333.

2. The Dictionary of Real Estate Appraisal (Chicago: The American Institute of Real Estate Appraisers, Chicago, 1984), p.107.

potential highway commercial or residential development. Or in the interest of conservation, a recreational type of water reservoir is constructed; adjacent property values skyrocket.

Direct windfalls are not so easily traced. Changes in zoning policy that increase the utility of a property are classic examples of factors that produce direct windfall profit.³ Another example is a sudden demand for mineral deposits that are present on a property--or a new technology that permits more profitable use of the land (such as, for example, a new method for handling sewage in rural land that will not accommodate septic tanks).

A sudden reduction of the property tax or other property-related expense would also create a direct windfall profit to the owner. Indeed, favorable tax treatment has long been a method used to provide incentive, through windfall profit, to rehabilitate or redevelop distressed and blighted property.

Windfall losses result from changes that decrease property value. Again, indirect losses most often result from changes produced by public projects: A new intercity highway splits a neighborhood, leaving part of the homes with more difficult access to shopping and other residential amenities. The properties that have lost land because of the public project are protected by laws of eminent domain and receive just compensation; but adjacent properties, some of which may experience the same disadvantage, are not compensated and consequently suffer a windfall loss. The proper appraisal term for this loss is "external obsolescence."⁴

3. It should be noted that zoning change that comes from entrepreneurship would not be considered windfall. This reference is to unsolicited zoning change that has a positive effect on property values.

4. Op. cit. supra note 2, p. 114.

Direct windfall loss results from changes that have a negative effect on a property's utility. Unlike indirect losses that are caused ultimately by external forces, direct losses derive from factors specifically associated with the property. Again, zoning is a classic example of a direct cause, and the question of down-zoning without just compensation has long been a lively issue.

Changes in property taxation can also cause windfall losses. Inequitable assessment practices often single out certain property types or locations for windfall loss, and the property owners must go through an appeal process to get relief. Special assessments to pay for public expenditures on sidewalks, flood control, or other off-site improvements result in additional ownership cost, but in these cases the benefit is expected to offset the loss. Unlike special assessments that usually affect only a small group of properties and result in improvements that will benefit that group, new tax levies or tax rate hikes for services not related to property cannot be recaptured in the market and therefore result in windfall loss to the property owners.

Appraisal techniques can be used to convert the amount of additional tax liability into an estimate of market value loss. The gain or loss in a property's market value resulting from windfall may be estimated by either (1) sales comparison or (2) income analysis. Sales comparison is an analysis process in which two recently sold properties similar in all respects but one are compared. The price differential indicates the difference in the market value that resulted from the difference being studied. For example, farm land where an interstate highway is planned now sells for \$500 per acre. After the highway is completed, land adjacent to the highway interchange will sell for \$2,000 per acre. The \$1,500-per-acre difference in sales prices of land close to the interchange and land elsewhere in the area is attributable to the effect on prices of the interchange

location; it can be classified as windfall profit.

In income analysis, the income of a property that is attributable to windfall is isolated and converted into a value estimate by means of a process called capitalization:⁵ Income produced by a property (usually through rental) can be expressed as a percentage of market value. This percentage is the capitalization rate. If the capitalization rate can be reliably estimated, then a property's market value can be estimated by dividing the income/rent that a property can command (usually net income) by the capitalization rate (the computation is called capitalization). For example, a property has a rental income of \$12,000 per year and a capitalization rate of 12 per cent; its value would be [$\$12,000 \div .12 = \$100,000$]. Obviously, when the income for a property is reduced or increased, the property's value is similarly affected. In the example used above, a windfall increase of rent in the amount of \$1,200 per year would produce a windfall profit of [$\$1,200 \div .12 = \$10,000$] to the owner, thus bringing the total value to [$[\$12,000 + \$1,200] \div .12 = \$110,000$].

In 1985, House Bill 1314 was introduced in the North Carolina General Assembly. It is now under scrutiny by a legislative study committee and may be considered in the short legislative session that begins this spring. If enacted as introduced, HB 1314 will abolish the property tax in North Carolina and replace it with a statewide sales tax and other forms of taxation not now available to counties. Repeal of the property tax, if passed, will represent a windfall profit to all real property owners in the state. The amount of windfall profit, expressed as an increase in property value, can be calculated by the income analysis method. In other words, the amount no longer paid

5. Ibid., p. 45.

in property taxes will be equivalent to increased rental income, and if that sum is capitalized at a proper rate, the computation indicates the increase in property value that will likely occur if HB 1314 is passed. The amount of property tax no longer paid will vary with the value of the individual property and the tax rate for the county where the property is located. For example, for a \$50,000 home located in a typical North Carolina county with a tax rate of \$0.96⁶ per \$100 of market value, the figure will be \$480. On the basis of a mortgage-constant capitalization rate of 13.5 per cent, this tax reduction of \$480 converts to a windfall profit of \$3,555.⁷ This phenomenon can be shown more dramatically with larger properties and greater market values. Say, for example, that a big office building in a major city is appraised at \$10,000,000. The tax savings for that property, at the effective tax rate used above, is \$96,000. This converts to a windfall profit, at the same capitalization rate used above, of \$711,111.

A new tax on real property produces a windfall loss. In 1985 the General Assembly passed two local-option bills that authorized Dare and Currituck counties and also the municipalities that border on the Atlantic ocean to levy an excise tax on the transfer of real property. The tax, if adopted by the local governments, will be minimal (\$1 on each \$100 of total sale price or lease value) and can well be ignored by the market; however, HB 1314--to repeal the property tax--will, if it passes, permit counties to levy a transfer tax of \$8 on each \$100 of the value transferred and may have a significant impact on the market. A potential buyer faced with paying a transfer tax on the purchase of a

6. This was the average effective tax rate for North Carolina in 1984. Significant Features of Fiscal Federalism, 1984 Edition; Washington, D.C.: ACIR, March 1985), p. 106.

7. The Appraiser (Chicago: AIRES, December 1985), p. 11. The capitalization rate used is the North Carolina average mortgage constant for used-house loans for October 1984. To convert tax savings to windfall profit, the tax savings is divided by the selected capitalization rate.

property will tend to deduct this cost from the amount offered for a property, much as a buyer offers less for a property that needs a new roof. Unlike the property tax, which occurs annually and must be capitalized for the estimate of total windfall profit or loss, a transfer tax would occur only once for each successive owner of the property--at the time of sale--and the amount of the tax is therefore the total amount of the windfall loss. Consequently, if HB 1314 passes and the transfer tax is adopted, all properties within a county--whether sold or not--will suffer an immediate windfall value loss in an amount equal to the pending tax. A transfer tax at 8 per cent of sales price converts to a \$4,000 windfall loss on a \$50,000 house sold at market value ($\$50,000 \times .08$). A \$10,000,000 office building in the same circumstance will suffer a windfall loss of \$80,000.

Windfall profit or loss occurs with sudden changes in the forces that affect property value. The examples of tax repeal and new tax levies are governmental/economic forces and are good examples of this market phenomenon. Other changes tend to be more subtle but will also affect property value and must be accounted for in the appraisal process. Making such assumptions cannot be done without a thorough analysis and complete understanding of the property tax system, historical precedent, and political/governmental trends. This is a constant challenge to the real estate appraiser and an important task for the professional candidate who is writing a demonstration appraisal report. Property taxes are a determinant of value, and the appraiser must address them in that frame of reference.

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HUNT REAPPOINTED AS PDA

IAAO President William A. Diggs, CAE, has reappointed Joe Hunt, CAE, as the Professional Designation Adviser (PDA) for North Carolina in 1986. The PDA is IAAO's liaison with designation candidates in this state and is responsible for promoting candidacy in the professional program and encouraging completion of the requirements for such designations.

President Diggs has specifically asked that each state retain the candidates currently in the professional program; recruit at least two new candidates; and have at least one candidate who receives either the RES or CAE designation. North Carolina should score 100% plus on all three points. In fact, North Carolina should lead the nation in new designees for 1986.

If you have any questions regarding the IAAO professional program, call Joe Hunt at the Institute of Government, Knapp Building 059A, The University of North Carolina at Chapel Hill, Chapel Hill, NC 27514. The telephone number is (919) 966-4372.

RESERVE BOOK COLLECTION FOR CANDIDATES' CLUB

The Institute of Government's library has reserved a shelf marked "Candidates' Club" for a collection of reading materials for the Club. The collection now consists of demonstration appraisal reports on residential, commercial, industrial machinery and equipment that have been successfully submitted for professional designations. Other materials intended to help you attain the professional designation will be gradually added. If you have any materials to donate or can suggest materials that you would like to see added to the collection, contact Joe Hunt at the Institute of Government.

LISTING OF NORTH CAROLINA PROFESSIONAL DESIGNEEES AND CANDIDATES

Professional Designations Awarded

Robert L. Bonti, CAE
 Michael W. Collier, RES
 Sidney H. Covington, CAE
 William P. Ferriss, CAE
 Lane M. Helms, CAE
 Joseph E. Hunt, CAE
 David J. McCall, CAE
 Ralph F. Neely, Jr., RES
 Felix R. Pollard, Jr., CAE
 Harry Schultz, CAE
 John C. Wallace, CAE
 Brice A. Wellmon, CAE

CAE Candidates

Dale O. Campbell, Catawba County
 Randall W. Moose, Catawba County
 Michael W. Collier, Cumberland County
 Wilton G. Rountree, Edgecombe County
 Jim H. Towery, Forsyth County
 Nolan K. Palmer, Haywood County
 S. (Tim) F. Westbrook, Lee County
 Carolyn Black, Mecklenburg County
 Deborah Z. King, Mecklenburg County
 John G. Korinis, Mecklenburg County
 Ralph F. Neely, Jr., Mecklenburg County
 Thomas L. Tucker, Mecklenburg County
 James S. Bethune, New Hanover County
 George W. Meyer, Jr., Orange County
 Bruce P. Stokes, Pitt County

Richard A. Beamer, Randolph County
 Douglas G. Elliott, Rutherford County
 Jerry F. Gant, Surry County
 J. D. Brickhouse, Tyrrell County
 Emmett D. Curl, Wake County

RES Candidates

David A. Turbyfill, Avery County
 Jack A. Williford, Bertie County
 Perry M. Grant, Bladen County
 Steve Crysel, Burke County
 Ralph D. Warlick, Burke County
 Ronald V. Antry, Craven County
 James J. Autry, Jr., Cumberland County
 Charles M. Hurley, Cumberland County
 Joe L. Whitley, Durham County
 William P. Isley, Forsyth County
 Carl G. Mericle, Forsyth County
 Mary Jean Presnell, Haywood County
 Margaret B. Claxton, Jackson County
 Cecil L. Dills, Jackson County
 Karl E. Gillespie, Macon County
 Donald W. Holland, Macon County
 Albert E. Boone, Nash County
 Charles K. Murray, Nash County
 John C. Bailey, N.C. Dept. of Revenue
 William E. Stevens, Pasquotank County
 James L. F. Smith, Pender County
 Juanita W. Barton, Transylvania County
 William W. Tester, Watauga County

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REGISTRATION FORM

North Carolina's Candidates' Club Meeting May 29-30, 1986
 Institute of Government
 The University of North Carolina at Chapel Hill

Mail to: Joseph E. Hunt
 Institute of Government, Knapp Building 059A
 UNC at Chapel Hill, Chapel Hill, NC 27514

Name _____ Social Security # _____

Title _____ County _____

Address _____

City _____ State _____ Zip _____

REGISTRATION FEE: A fee of \$5.00 per person will be payable on arrival. Please do not send money in advance.

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