VIRGINIA DEPARTMENT OF TAXATION

Guide to Understanding Real Estate Assessment Values

Property Tax Section

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[A brief overview of the real estate valuation processes typically used in local real estate assessment offices.]

INTRODUCTION

Often misunderstood, this Guide has been developed to help Virginia real property owners and taxpayers better understand the real estate valuation processes typically used in local real estate assessment offices.

In days past the Commonwealth relied upon its citizens to estimate real estate assessment values. This system worked well enough when real estate markets were relatively static and where properties were generally similar in nature.

Recent decades have witnessed rapid changes in real estate markets, both in terms of activity and complexity. Additionally, the growth of local government and a rise in local funding needs have focused the public's attention on property tax to an extent heretofore unknown. The time-honored system of assessments made by lay citizens has proved to be unworkable and very likely to produce inaccurate and inequitable assessments.

In order to satisfy Virginia's constitutional mandate requiring fair market value assessments, localities have found it beneficial to employ professional appraisers/assessors either to assume legal responsibility for conducting reassessments or to act as technical assistants.

Assessors and their appraisal staff are expected to be knowledgeable in assessment methodology and process, to be knowledgeable of applicable Virginia and local laws, to approach their duties with an open mind, and exercise impartial judgment in the development of assessment values. Since 1976, the Department of Taxation has offered basic and advanced courses for improving appraisal knowledge and job skills.

UNDERSTANDING REAL ESTATE ASSESSMENTS

A proper understanding and application of the term *assessment* is fundamental to understanding real estate assessments. Defined in the Virginia Tax Administrative Code, Code Section 23VAC10-500-580:

"Assessment" means a determination as to the proper rate of tax, the measure to which the tax rate is applied, and ultimately the amount of tax, including additional or omitted tax, that is due. An assessment shall include a written assessment made pursuant to notice by the assessing official or a self-assessment made by a taxpayer upon the filing of a return. Its use can apply to an individual property, or to all properties in a grouping.

The definition encompasses several components:

> The *rate* at which property will be taxed (the tax rate)
> The *measure*, or *value* of property to be taxed (the assessment or assessed value)
> The *total amount of the tax* on property that will be billed (the tax levy)

Some may refer to only one of these components when using the term, which can lead to confusion. To avoid any confusion, one must be aware of and consider all three components of the definition during assessment discussions.

However, for the purpose of this Guide, the term “assessment” is synonymous with “assessment value” or “assessed value”, being those values that best assure a total real estate tax levy that is equitably borne by the property owners of a locality.

Constitutional and Statutory Mandate

The *Constitution of Virginia*, in Article X, mandates that all property shall be taxed, and further stipulates that all taxes shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax. Other provisions of Article X require that all assessments of real estate shall be at fair market value with the exception of those assessments of certain real estate devoted to agricultural, horticultural, forest and open space uses, which may be granted preferential assessments. In addition, Article X segregates real estate as subject to local taxation only, with the provision that real estate shall be assessed in such manner and at such times as the General Assembly may prescribe by general law.

The statutes controlling real estate assessments and reassessments are located in Chapter 32, of Title 58.1, of the *Code of Virginia*. Generally, these statutes are numerous and beyond the scope of this discussion. However, an understanding of some statutes may be helpful.

Virginia law requires periodic reassessments of real estate in every taxing jurisdiction. Some jurisdictions reassess annually, however, by law six years is the most time allowed between reassessments for counties; four years for cities. Population thresholds may require more frequent reassessments, and the local governing body may determine the need to reassess more frequently.

Local governing bodies are not permitted to reap revenue windfalls due to an increase in assessed values (see § 58.1-3321, *Code of Virginia*). Subsequent to a reassessment, the local governing body must reduce the levy by lowering the tax rate as to produce no more than 101 percent of the revenue generated in the previous year. If a higher rate is necessary, the governing body must advertise the increase and conduct a public hearing on the matter. ***This safeguard has been put into law since the responsibility for increasing local government revenues should be properly borne by the governing body and not by the assessing officer.*** This limitation applies only to total revenues; the actual tax bill of an individual property owner may increase at a greater rate.

Following general reassessment, the tax rate approved by the local governing body is applied to the new values. The assessments are not responsible for increases or decreases in the real estate tax levy. The local governing body has the sole responsibility for determining the real estate tax levy by setting the tax rate in accordance with the budgetary needs of the locality.

The assessed values established during a general reassessment are applicable until another general reassessment occurs. Examples of permitted changes are those caused by factual or clerical errors, rezoning, subdivision of land, and construction or destruction of buildings.

New land parcels or new buildings created between reassessment cycles shall be assessed uniformly with the assessments made on similar property during the most recent general reassessment.

The *Code of Virginia* requires that the tax is levied at 100% of appraised value. Prior to 1977, the tax levy for most localities was based on a fraction of the appraised value. The fraction varied from one locality to the next and from one general reassessment to the next. This system masked inequalities and made it difficult to compute the true tax rate or to compare the assessed value for one property with the assessed value of a similar property. In 1975, the General Assembly amended Section 58.1-3201 of the *Code of Virginia* to require that local tax levies effective in 1977 or after is based on 100% of appraised value.

In accordance with Virginia law, real estate reassessments are overseen by the Commissioner of the Revenue, by a Board of Assessors, or by a Professional Assessor, who is someone appointed by the local governing body, and who is either an employee meeting the qualifications prescribed by the Department of Taxation or an independent contractor holding valid certification issued by the Department. That person or body is recognized, for the purposes of this Guide, as the Assessing Officer.

Fiscal Well Being of the Locality

A significant portion of local government revenue is derived from real estate assessments. With local support, tax rates can be adjusted to meet changing revenue needs. The fiscal health, the services provided, and the level of confidence in local government all rely in part on accurate real estate assessment valuations. Improper assessment practices can result in inequitable assessment values and/or outdated values.

The ability of local governments to utilize bond financing is limited to a percent of debt to total assessed real estate value. In addition, bond ratings may be based on the total assessed value of the real estate of the locality.

Real estate values typically reflect public expenditures for services and capital improvements. As a measure of the wealth of a locality, it is possible for a higher total assessed value to result in a higher bond rating and a lower interest rate.

Real estate values play an important role in the distribution of state aid to elementary and secondary education. This aid is distributed by a formula that factors both need and the local tax effort to ensure that all localities are able to finance the major costs of the Standard of Quality in the State. The estimated true value of all taxable real estate in each locality, the 100% fair market value estimate, is a key component in the formula for aid distribution.

It should be recognized that the fiscal well being of a locality is only truly maximized when assessed values are equitable and represent fair market values.

Fair Market Value

Code of Virginia, § 58.1-3280. *Assessment of values*

Every assessor or appraiser so designated under this chapter shall, as soon as practicable after being so designated, proceed to ascertain and assess the fair market value of all lands and lots assessable by them, with the improvements and buildings thereon. They shall make a physical examination thereof if required by the taxpayer and in all other cases where they deem it advisable.

Fair Market Value is the term used in the Constitution of Virginia, the *Code of Virginia*, and Virginia courts when addressing the assessment value of property. Virginia does not have a statutory definition for fair market value. Instead, having evolved from its application in a series of court cases over a number of years, fair market value is generally accepted to mean:

"The fair market value of property is the price which it will bring when it is offered for sale by one who desires, but is not obliged, to sell it, and bought by one who is under no necessity of having it",

(See *Tuckahoe Women's Club v. City of Richmond*, 119 Va. 734, 101 S.E.2 d571 (1958))

The Assessing Officer develops estimates of fair market value that are the basis for assessment equalization. Though not defined in Virginia law, fair market value is commonly viewed by the assessment community as the *equitable* market value of property, that is, Equity plus Market Value equals Fair Market Value.

Price, Cost, and Value

The concepts of *price*, *cost*, and *value* should not be confused.

Price is the amount actually paid for a property in a particular transaction. Price is a historical fact; it is not a prospective concept. The price paid is the amount a particular buyer has agreed to pay and a particular seller has agreed to accept under the conditions surrounding their transaction.

Cost refers to production, not exchange. It is the expenditure required to produce property, such as the cost of constructing a building. Cost can be a historical amount, a current amount, or a prospective amount.

The Dictionary of Real Estate Appraisal defines *value* in a general sense as "the monetary worth of a property, good, or service to buyers and sellers at a given time." In contrast to price, the concept of value has a prospective aspect, in that the value at a given time reflects an anticipation of benefits to be received in the future.

Market Value vs. Market Price

Market Value is an appraisal term that applies to a hypothetical concept, not an established fact. Definitions of market value are recognized by different organizations, and can vary somewhat. Most definitions include components for an estimated probable selling price, at a particular point in time; assume a sale that occurs between informed parties acting for their own best interests, and without duress. Other definition components may include:

> Allowing adequate time to sell the property;
>
> Proper exposure to the open market;
>
> An "arm's-length" transaction, i.e., one not involving love and affection or other non-monetary consideration;
>
> A sale transacted on typical terms with regard to financing and conditions of sale;
>
> A value that reflects the property's highest and best use

Market Price, on the other hand, is a fact. It is the actual number of dollars for which a property has sold. The two terms do not mean nor do they necessarily represent the same thing. Because a property sold at a particular price, does not mean that the sale price is its market value. The data from a number of qualified sales are analyzed, together with other market value indicators, for an estimate of market value, which may be more or less than a recent market price.

The Assessing Officer is not expected to predict the actual selling price of specific properties. Market value is the *estimated* probable selling price of a property at a particular point in time. Simply stated, it can be viewed as the ***point around which market prices will tend to cluster***.

Equalization and the Assessment Process

The primary goal of a reassessment is to establish property values that best assure a real estate tax levy that is equitably borne by the property owners of the locality. In doing so, the Assessing Officer must strive for an overall assessment level of 100% of fair market value.

For unique properties, an individual appraisal of a property may be performed. However, fair and equitable assessments require utilizing accepted mass appraisal standards and techniques that are applied ***uniformly,*** and are in accordance with state statutes and local ordinances. The Commonwealth of Virginia recognizes and accepts procedures, rules, and standards as prescribed by nationally recognized professional appraisal organizations such as the International Association of Assessing Officers (IAAO).

Complete and Accurate Records

The assessment process begins with and relies on a complete and accurate file of all properties within a jurisdiction, a Property Record File. This means that records have been created for each parcel. Ideally, the records contain current, complete, and accurate descriptive information about the land and the improvements to each parcel. This includes, among other things, data concerning ownership, parcel location, physical characteristics, and use. If the property is improved, the Assessing Officer must record all improvements; ascertain age, size, condition, type, quality of construction, and other relevant characteristics. The Assessing Officer must work with the best available data at any given point in the assessment cycle.

Though striving for the ideal, it must be understood that in many localities there is rarely the opportunity to inspect the interiors of all properties being valued during the assessment cycle, that data collected is subject to change without notice, and that file data can soon become outdated.

Mass Appraisal, Classification and Stratification

There are differences between the appraisal of a single property and mass appraisal used for real estate assessments. When estimating value, the fee appraiser is typically limiting his analysis and conclusion to a single property, or single type of property. Most property owners experience this process when a fee or single property appraisal is made for their property, often in conjunction with financing or refinancing.

When estimating the value of all properties within the jurisdictional boundaries of a locality, the Assessing Officer develops value estimates for groups of similar properties utilizing mass appraisal techniques, which typically include the collection and statistical analysis of large amounts of data. One technique employed is the classification and stratification of the properties.

In accordance with the *Code of Virginia* (§ 58.1-208) and for assessment purposes, all real property is classified. The classification identifies a group of similar properties as a property type. The Department of Taxation has established seven broad classes of real estate for use by Assessing Officers in Virginia.

Department of Taxation Property Class Codes	
Class	**Class Name**
01	**Single-Family Urban**
02	**Single-Family Suburban**
03	**Multi-Family Residential**
04	**Commercial and Industrial**
05	**Agricultural or Undeveloped - 20 to 100 acres**
06	**Agricultural or Undeveloped - over 100 acres**
07	**Tax Exempt**

Assessing Officers may subdivide the seven classes, as deemed necessary, for more specific and accurate appraisal. Once classified, the properties within a classification are then stratified. A class of properties may be stratified according to its characteristics, and the relationship of those characteristics to market value. A property may be classified as 01 Single-Family Urban. It is recognized that not all 01 Single-Family Urban properties will have the same characteristics. The Assessing Officer may use a Construction ranking or grade, for example, Poor through Excellent, A through E, or 1 through 5, to identify different strata within a classification, and then will relate each stratum to a value level. With all properties in the jurisdiction properly classified, and stratified, the Assessing Officer will collect and analyze market value indicators.

Market Value Indicators

Various forms of data that will provide market value indicators must be assembled in order to develop reliable estimates of value. This includes data pertaining to local economic conditions, planning and zoning regulations, and neighborhood boundaries. Additionally, current construction cost data, income and expense data for rental properties, and recent qualified real estate sales must also be compiled. Sources of this information include public records, real estate and construction professionals, property owners and physical inspections.

With the collection of market value indicators, the Assessing Officer can begin the process of analysis, applying sound judgment, together with the best practices of the assessment field in order to develop reliable estimates of market value.

Approaches to Value, Analysis, Modeling, and Model Calibration

The appraisal profession generally relies on three traditional approaches to an estimate of value. These are the cost, sales comparison, and income capitalization approaches**.** All are based on accepted economic principles.

Cost Approach: most suitable for new, unique, or special purpose properties, and is the cost to construct a reproduction or suitable replacement of the improvements, less the accrued depreciation, added to the value of the land to provide a total estimated value for the property. The applicable economic principle is substitution; i.e., a prudent purchaser would not pay more for a property than the cost of building a reproduction, replacement or suitable substitute for it.

Sales Comparison Approach: most suitable when there are sufficient sales. The sale prices are analyzed, and adjustments are made to reflect any differences between the properties sold and the property being valued. Again, the principle is that of substitution, i.e., a prudent buyer would not pay more for a property than the price to purchase a similar property.

Income Capitalization Approach: is most suitable for commercial and multifamily income producing properties. Rental income and operating expenses are analyzed and calculations made for an estimate of what a property can earn for its owner. The net income to the owner is then capitalized into an estimate of value. The economic principle governing this concept is anticipation, that is, value equals the present worth of the future net benefits of ownership.

In the appraisal process, one approach may be more applicable to one property classification than to another. When reconciling the various approaches an appraiser may select, or accord more weight to the approach that is most applicable to the property type being valued.

Assessing Officers utilize verified market value indicators, statistical analysis, traditional approaches to value, and property classifications and characteristics to construct Valuation Models for various property classes and stratum. Although Models can vary and are generally more complex, the example below illustrates a stratification level, and the Base Value for those properties sharing the characteristics identified.

Valuation models provide a uniform basis for developing equitable assessment values, and can be calibrated to reflect changing market conditions. Modeling also allows for adjustments to be made for differences among the various properties within property classification strata. In our example, which would be developed from an analysis of market value indicators, a base Model value of $100 per square foot of gross building area is estimated.

Assessment Model							
Class	Description	Strata	Characteristics				Base Value
			Structure Age	Structure SF	# BRs	# Baths	
01	**Single-Family Urban**	**Average**	**15 years**	**1500**	**3**	**1.5**	**$100/SF**

Adjustments and Market Value Estimates

Analysis is also performed to develop value estimates for adjustments that may be applied to the base values. Characteristics such as a garage or extra bathrooms would likely result in added value or positive adjustments to the base value. Characteristics such as fewer bedrooms or an irregular shaped lot may result in reduced value or negative adjustments to the base value. Some characteristics, such as a significant size or age variation, may result in a positive or negative adjustment. With the application of the adjustments to the base value, the assessment values for individual properties can be estimated.

Adjustment Grid: 01- Single-Family Urban									
Property Number	Class Type	Strata	SF	Base Value	Adjustments				Assessed Value
					1	2	3	4	
# 1	01	Avg	1800	$100/SF	+$10,000 (garage)	+$1,500 (two full baths)	-$2,500 (irregular lot)	-1.00/SF (size of structure)	$187,200
# 2	01	Avg	1600	$100/SF	+$10,000 (garage)	+$1,500 (two full baths)	N/A	N/A	$171,500
# 3	01	Avg	1750	$100/SF	+$1,500 (two full baths)	-1.00/SF (size of structure)	-3.00/SF (age of structure: 25 yrs)	N/A	$169,500

We see from our illustration above that even though multiple properties can be in the same stratum of a specific classification, their values can, and often do differ. What is important is that properties were properly described, classified, stratified, and the values were developed in a ***uniform*** and ***equitable*** manner.

In recent years, more and more localities are relying on computerized assessment systems. Property data is updated, stored, statistical computations are performed, and calibrations are made to Valuation Models based on current market information. When managed properly by knowledgeable appraisal professionals, the computer-based assessment system will perform calculations that result in uniform and equitable fair market value assessments.

Indexing or Trending

There may be times when data is not available in sufficient quantity or quality for some property groups, be it a geographical area or a property type. This can occur in localities having short reassessment cycles, a variety of property types, and/or a number of unique properties. In order to establish overall equity in the locality, Assessing Officers may rely on indexing, or trending values based on changes in broader segments of the local market. The Assessing Officer will attempt to relate value changes in property groups similar to the group lacking sufficient data.

For example, the Assessing Officer finds that there is insufficient data to develop new values for Property Group-A. However, for Property Group-B, which has similar characteristics to Group-A and sufficient data for traditional valuation methods, it is determined that values have dropped 3%. In the absence of other reliable data, the Assessing Officer would have a supportable basis for value adjustments to Property Group-A based on overall changes in the similar Property Group-B.

Consistent, Supportable and Explainable

There are various acceptable techniques for developing assessment values. Practice of the appraisal profession with any degree of confidence requires experience and study (which the appraiser should continue throughout his career). The indispensable ingredient is good, impartial judgment. The goal of the Assessing Officer is the unbiased development of fair and equitable assessment values. What is required of any Assessing Officer is that assessment values be consistent, supportable, explainable, and of course, reliable. Assistance with particular valuation questions is available from the local professional staff or from the Department of Taxation Property Tax Section.