AD VALOREM PROPERTY TAXATION ADMINISTRATION IN WYOMING

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Property taxation in the State of Wyoming has evolved along a path that places the individual property taxpayer in an adversarial position versus both the state and local government administrative bodies. Although not the intention of either the State legislature or the State Supreme Court, the state government's executive body and its adjunct administrative agencies have placed administrative expediency ahead of property tax fairness and equity.

In 1989 the Wyoming State Supreme Court held unconstitutional the statutory provisions utilized for taxing real property within the state.[2] The Court required the legislature to provide for uniform assessment to secure a just valuation and equal and uniform taxation in compliance with the pertinent constitutional provisions. The Wyoming legislature addressed those concerns in 1988 by sponsoring and amendment to the state constitution to provide for uniformity of assessment of land and improvements. Provisions within the state constitution and statues charged the State Board of Equalization with administration of ad valorem property taxes in Wyoming. Members of the 3-member Board are appointed by the Governor.

The legislature's constitutional amendment required that property shall be uniformly valued at its full value; this was understood to be "fair market value" (FMV). The importance of FMV was elucidated in 1994 in a clarification with respect to the roll of the Board. The Board shall prescribe the system of establishing the fair market value. Moreover, the Board, after securing approval from the director of the Department of Revenue, shall prescribe by rule and regulation the appraisal methods and systems for determining fair FMV using ***generally accepted appraisal standards***.[3]

There is one overarching principle that guides all major professional valuation associations dedicated to the determination of FMV for real property, this includes the Appraisal Institute, the oldest and most respected appraisal organization, and the International Association of Assessing Officers, the association representing primarily property tax assessors: there are ***only three approaches to value***. The three approaches to value are founded on the cost approach, the sales comparison approach and the income approach.

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[2] Rocky Mountain Oil and Gas Association v. Bd. Of Equalization, <u>749 P. 2d 221</u> (Wyo.1987)

[3] WYO STAT. § 39-2-102 (1994).

Further examination of these approaches will disclose that each is driven by market information. In the case of the cost approach detailed information on the cost to construct buildings and indications of property depreciation is gleaned from investigations into market activity. The land value component of the Cost Approach is derived from market transactions. Information utilized in the income approach again must be derived from market information on comparable rents, capitalization rates and operating expense. The sales comparison approach utilizes actual transactions to infer property valuations.

While many noted scholars have labored to clarify and improve on the understanding of appraisal theory and practice, the Wyoming State Board of Equalization appears to have moved in another direction. The Board's rules and regulations provide for 8 methods, not three, for valuing property; they include the following:

a) The Sales Comparison Approach
b) The Stock and Debt Approach
c) Replacement Cost Approach
d) Reproduction Cost Approach
e) Historical Cost Approach
f) The Ellwood or Mortgage Equity Method
g) The Income Capitalization Earnings Approach
h) Computer Assisted Mass Appraisal (CAMA)[4]

The Sales Comparison Approach is the foundation of all real estate valuation and it should be noted the Board is consistent with established valuation standards in listing it as an appropriate method. The Stock and Debt Approach is not really a standard real estate valuation method, rather it is used to appraise companies and involves looking into the company's corporate stock and forms of debt. Often times it is applied to the valuation railroad companies. Technically it should be classified as an element incorporated into the Income Approach.

The Replacement Cost and Reproduction Cost Approaches are closely related. Reproduction cost reflects an exact replica of the property while replacement cost is based on a substitute property with similar utility. Here again the market is a determining factor and suggests that if a replica would suffice replacement cost would be appropriate.

If the market is actually valuing a reproduction of the physical features of the improved property then Reproduction Cost should be used. Reproduction Cost could include a significant amount of functional obsolescence making it difficult to estimate; nonetheless, both Replacement Cost and Reproduction Cost are elements of the Cost Approach.[5] It should be noted that the appraiser must add

[4] Rules and Regulations of Wyoming Board of Equalization, Ch. XXII, Section 6.

[5] Appraisal Institute, *The Appraisal of Real Estate,* 12th ed. (Chicago: Appraisal Institute, 2001), pp. 357-8.

the value of a land component to arrived at a total Cost for the property; the land value often will be based on subjective judgment by the appraiser/assessor.

Historical Cost is not found in "generally accepted" appraisal literature, although it could be categorized as an element of Reproduction Cost. The term is more generally associated with accounting practices, where it represents the acquisition cost of a property. It is interesting to note that the Board would include historical cost as an acceptable determinant for FMV while assessors are reluctant to use historical value since it would legitimize the actual sale price that was recorded for a property in the past, rather than a value that was artificially estimated by the assessor. In actual reality this form of Historical Cost more closely represents FMV than does any of the other "8 methods" authorized by the Board of Equalization. Ironically when property owners have claimed the appropriate valuation for their property is the price they paid they have generally been overruled by the Assessor, the County Appeals Board and the State Board of Equalization in favor of some more artificial estimate of "FMV."

The Ellwood or Mortgage Equity Method is an important component of the modern-day Income or Capitalization Approach. Prior to the widespread use of computers appraisers would capitalize one year's net income, which was "normalized" to reflect market conditions. L.W. Ellwood advocated the introduction of a differentiation between debt and equity in the valuation of income producing property and rather than a static view of cash flow as coming in one year, he emphasized cash flow as coming over a period of time well into the future. The Ellwood technique, as well mortgage equity considerations advanced by Charles Ackerson, added a new dimension to appraisal practice and are well integrated into the traditional Income Approach to value.

The final method authorized by the Board was Computer Assisted Mass Appraisal (CAMA): this "method" deserves further clarification. First it should be noted that any professional person associated with either appraisal or assessment will acknowledge that CAMA, as the name suggests, is merely the use of a computer in generating mass appraisal rolls, and it is not a *generally accepted appraisal* method and the Board is incorrect in naming it as an appraisal method.

Mass appraisal is the practice of assessors assigning valuations to all properties within the tax jurisdiction and may or may not be automated with assistance from a computer. Since assessors need to value large numbers of properties within a limited period of time sometimes shortcuts are devised. Originally the most broadly applied shortcut was the estimate of a replacement cost. It was not uncommon for assessors to assign land values that remained fixed for several years and then add the replacement cost.

Unfortunately this was the type of system that the Wyoming Supreme Court found to be unconstitutional and demanded an approach that was more reflective of some form of *fair market value*. In reading of the Wyoming legislature's intention they too anticipated a system that was more inclusive of values determined by market transactions. Clearly their objective was to obtain a computer assisted system of mass appraisal that incorporated market-based valuations which were complements to the established cost approach, thus yielding a defensible estimate of FMV.

The CAMA system contains two components that were intended to generate *generally accepted appraisal* methods:

1. Replacement cost as calculated by the Marshall & Swift computerized cost routines; and,
2. Simple and Multiple Regression estimates that inferred values through the use of mathematical equations drawn from sales data that was processed by the Statistical Package for Social Science (SPSS) computer routines.

The CAMA system also incorporates data manipulation routines operated on an Oricle platform which would supply Assessment/Sale Ratios using the assessed value and the price of recent sales: this is not an accepted means of valuing individual properties.

The statistical equations derived from the Multiple Regression programs that State administrators thought would yield market derived estimates of property values have proven to be ineffective for several reasons:

1. Wyoming is a diverse state, and the data necessary for estimating regression equations is not readily available;
2. The underlying statistical equations require very specific assumptions that are not generally met;
3. Assessors throughout the state have found the use of regression equations to be a mystery they have been unable to solve; and,
4. In those limited instances where assessors have attempted to use regression estimates to infer property values, they have incorrectly applied the technique.

It is not surprising that most elected assessors have found the use of regression analysis to be an enigma. The IAAO has cautioned prospective users of multiple regression analysis of several weaknesses:

1. MRA requires a high level of statistical knowledge—market analysts must possess significant background in data analysis and statistical methods;
2. Predictive accuracy is restrained by assumptions;
3. MRA requires data sets that meet the test of sample size—there must be a significant number of sales in order to generate stable statistical results; and,

4. Interactive and nonlinear market trends are difficult to measure without transforming data—a special function of the SPSS program that requires technical skill and experience.[6]

The **CAMA system is clearly not a *generally accepted appraisal* method**; it contains only one component—the cost approach--that can be considered an effective valuation method uniformly throughout Wyoming. Failure of the CAMA system to generate accurate and stable multiple regression estimates has limited the capacity for assessors supply indications of market value based on input from comparable sales data; this is not what the Wyoming Supreme Court nor the Wyoming legislature intended and CAMA as a system should be removed from the Board's list of authorized appraisal methods.

As mentioned above, one of the elements within the CAMA system involves data operations with the primary data manipulation being the calculation of the relationship between the total assessed value and the sales price for a specific property; this is the assessment/sale ratio. The primary use of assessment/sale ratios is by the Board of Equalization in evaluating uniformity in assessments. It uses the ratio data to determine if the individual county assessments are below 95% of the sale prices, if this is the case they will order the county to readjust its assessments.

Unfortunately there is another application that assessment/sale ratios are being applied to and that is the adjustment of individual property values. Ratio studies are not considered to be a primary tool in the determination of individual property valuations. IAAO Standards, recognized throughout other jurisdictions in the United States, cautions:

> Assessors, appeal boards, taxpayers and taxing authorities can use ratio studies to evaluate the fairness of funding distributions, the merits of class action claims, or the degree of discrimination. However, ratio study statistics ***cannot be used to judge the level of appraisal of an individual parcel***.[7]

It can be correctly stated that application of the CAMA system in the State of Wyoming does not include a market-based indication of value. Moreover, there are only three *generally accepted appraisal* methods, not eight as mandated by the State Board of Equalization. These administrative error require immediate attention by the State legislature.

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[6] IAAO, *Standard on Automated Valuation Models (AVMs),* September 2003, p. 12.

[7] IAAO, *Standard on Ratio Studies*, Part 1, Guidance for Local Jurisdictions, July 2007, p. 7.