

MEMORANDUM

TO: Interested Parties

FROM: David Beggs, Program Director
Property Tax Administration

SUBJECT: Rule Workshop on First and Eighth Criteria

DATE: November 25, 2003

The Department of Revenue is conducting a rule development workshop for the purpose of receiving input on the review methodology that the Department will use to analyze the appropriateness of the fifteen percent threshold for documenting adjustments under s. 193.011(8), F.S. In preparation for this workshop, the attached preliminary analysis has been prepared. It's purpose is to summarize available information on what costs should be considered by property appraisers in arriving at just valuation pursuant to ss. 193.011(1) and (8), F.S., to examine the Department of Revenue's responsibility for overseeing the application of these criteria pursuant to 12D-8.002(4), F.A.C., and to discuss possible research methodologies to validate the most appropriate thresholds the Department should use in fulfilling its responsibilities.

The workshop will be on Wednesday, December 3, 2003 in Room 116 Larson Building, beginning at 10:30 a.m. Any input that you might have, either at the workshop or in writing prior to or after the workshop would be appreciated. Please address any comments to: Ms. Sharon Gallops, Tax Law Specialist, Department of Revenue, Property Tax Technical Unit, P. O. Box 7443, Tallahassee, Florida 32314-7443.

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Estimating the Impact of the First and Eighth Criteria on Just Value Preliminary Analysis

Purpose: The purpose of this analysis is to summarize available information on what costs should be considered by a property appraiser in arriving at just valuation pursuant to ss. 193.011(1) and (8), F.S., to examine the Department of Revenue's responsibility for overseeing the application of these criteria pursuant to 12D-8.002(4), F.A.C., and to discuss possible research methodologies to validate the most appropriate thresholds the Department should use in fulfilling its responsibilities.

Statutory Provisions : Section 193.011, F.S., provides the following, in part:

Factors to consider in deriving just valuation — In arriving at just valuation as required under s. 4, Art. VII of the State Constitution, the property appraiser shall take into consideration the following factors:

(1) The present cash value of the property, which is the amount a willing purchaser would pay a willing seller, exclusive of reasonable fees and costs of purchase, in cash of the immediate equivalent thereof in a transaction at arm's length;

.....

(8) The net proceeds of the sale of the property, as received by the seller, after deduction of all of the usual and reasonable fees and costs of the sale, including the costs and expenses of financing, and allowance for unconventional or atypical terms of financing arrangements. When the net proceeds of the sale of any property are utilized, directly or indirectly, in the determination of just valuation of realty of the sold parcel or any other parcel under the provisions of this section, the property appraiser, for the purposes of such determination, shall exclude any portion of such net proceeds attributable to payments for household furnishings or other items of personal property.

Rule Provision: Subsection (4) of 12D-8.002, F.A.C., provides the following, in part:

(4) Accompanying the assessment roll submitted to the Executive Director shall be, on a form provided by the Department, an accurate tabular summary by property class of any adjustments made to recorded selling prices or fair market value in arriving at assessed value. Complete, clear, and accurate documentation for each adjustment under section 193.011(8), Florida Statutes, exceeding fifteen percent shall accompany this summary detailing how that percentage adjustment was calculated. This documentation shall include individual data for all sales used and a narrative on the procedures used in the study.

DOR Responsibility: Florida’s Constitution requires that property be valued at just, or market, value. In arriving at this value, s. 193.011, F.S., provides eight factors that property appraisers are to take into consideration. Two of these, the first and eighth, involve fees and costs of sale, tangible personal property and atypical terms of financing, among other things. By rule, the property appraiser must submit a summary of adjustments made to selling prices in arriving at assessed value. The rule also requires that specific documentation for each adjustment under s. 193.011(8), F.S., which exceeds fifteen percent be included detailing how the adjustment percentage was calculated.

The Department’s role in this process is twofold. First, the summary information concerning adjustments is used in the Department’s tax roll studies to determine levels of assessment. Second, the rule implies that there will be increased scrutiny of adjustments made pursuant to s. 193.011(8), F.S., which exceed fifteen percent in order to assure that the provisions of s. 193.011, F.S., are being followed. Under this structure, it is the property appraiser who is responsible for determining just value. Any change in the fifteen percent requirement merely changes the threshold at which increased Department scrutiny will begin. It is important that this threshold be reasonable in relation to the true costs to be considered under s. 193.011, F.S.

Costs to Consider: In examining costs that should be considered pursuant to s. 193.011, F.S., there are two primary considerations. First, there are some costs associated with a closing that are clearly not included in the statutory provisions, such as insurance or tax reserves deposited with a lender. While a cost of closing, these represent prepayments of later costs to the buyer.

Second, there is a distinction between costs paid for by the seller and costs paid for by the buyer. In discussions with real estate closing professionals, the typical starting point in a closing is the “contract price”. At closing, costs to the seller are subtracted from the proceeds received from the sale. Costs to the buyer, however, are charged to the buyer and are in addition to the contract price. Based on the discussions with real estate closing professionals, it is the contract price which is entered as the “sale/transfer” price on the DR-219.

Based on these considerations, the following analysis assumes that for typical transactions only costs to the seller should properly be included when considering ss. 193.011(1) and (8), F.S. Costs to the buyer are over and above the contract price and should not be considered.

Residential Property: For residential property, the industry standard settlement or closing statement is the HUD–1 form. Table 1 lists the closing costs included on this form. Indicated on this table is a preliminary conclusion as to whether the cost category is appropriate for consideration as part of ss. 193.011(1) and (8), F.S., and, based on discussions with real estate closing professionals and information in the HUD report referred to below, whether the cost is typically paid by the buyer or the seller.

In the Spring of 2000, the U.S. Department of Housing and Urban Development (HUD) issued a summary report on on-going research into the size and nature of closing costs as reported on HUD-1 forms filed for mortgages insured by the Federal Housing Administration. This report is available on the Internet at:

<http://www.huduser.org/periodicals/ushmc/spring2000/summary-2.html>.

The report looks at the size of reported closing costs and at which party typically pays. Table 2 is a summary of the findings in the HUD report, including estimates for those costs that would fall under the provisions of ss. 193.011(1) and (8), F.S.

Not included in the HUD study are at least two items that fall under the provisions of s. 193.011, F.S. These are:

- payments for household furnishings or other items of personal property; and
- allowances for unconventional or atypical terms of financing arrangements.

These have been omitted from the items listed in Table 1. Based on discussions with real estate closing professionals, it is relatively rare for the contract price (on which the documentary stamp tax must be paid) to include personal property. As to atypical costs of financing, while they should certainly be considered pursuant to s. 193.011, F.S., because they are by nature atypical it is assumed that they should not be a part of the determination of an appropriate threshold for the Department to include in rule.

Commercial/Industrial: A standard closing form similar to the HUD-1 used for residential sales has not been found for commercial sales. Table 3 has been constructed based on conversations with real estate closing professionals. The major commercial closing costs identified are:

- Real estate brokers commission
- Items payable in connection with loan
- Legal fees
- Documentary stamp taxes
- Environmental fees
- Appraisal fees
- Title insurance
- Survey

These costs are included in the table along with an indication as to which party typically pays the cost and an example of such costs based on a contract price of \$500,000.

Potential Study Methodologies: Based on the above analysis, it appears that there is evidence that the 15% threshold currently included in 12D-8.002, F.A.C., may be too high and that additional study is warranted to arrive at a more reasonable threshold for Department oversight. Also, the available data indicates that the appropriate threshold may be different for different types of property. It is important that any change be founded in actual practices in the real estate industry. Possible methods for analyzing costs associated with ss. 193.011(1) and (8), F.S., include:

- For residential costs, obtaining from HUD a sample of HUD-1 forms filed with the FHA.
- Select a sample of qualified sales by strata from the county property tax rolls and survey buyers and sellers within each stratum as to the actual costs of sale that would be included in considering s. 193.011, F.S.
- Survey real estate closing professionals as to the typical costs associated with a sale and which party typically pays. It would be important to differentiate various strata of property and to survey professionals within their area of expertise.

Table 1
Settlement or Closing Charges Included on HUD-1 Form

HUD-1 Form Categories		Appropriate for 1st & 8th Criteria Consideration	Typically Paid by Buyer	Typically Paid by Seller
700	Total Sales/Broker's Commission			
	Sales commission	Y		X
800	Items Payable in Connections with Loan			
	Loan Origination Fee			
	Loan Discount			
	Appraisal Fee	Y	X	
	Credit Report	Y	X	
	Lender's Inspection Fee	Y	X	
	Mortgage Insurance Application Fee	Y	X	
	Assumption Fee	Y	X	
900	Items Required by Lender to be Paid in Advance			
	Interest			
	Mortgage Insurance Premium			
	Hazard Insurance Premium			
1000	Reserves Deposited with Lender			
	Hazard Insurance			
	Mortgage Insurance			
	City Property Taxes			
	County Property Taxes			
	Annual Assessments			
1100	Title Charges			
	Settlement or closing fee	Y	Varies	Varies
	Abstract or title search	Y	Varies	Varies
	Title examination	Y	Varies	Varies
	Title insurance binder	Y	Varies	Varies
	Document preparation	Y	Varies	Varies
	Notary fees	Y	Varies	Varies
	Attorney's fees	Y	Varies	Varies
	Title insurance			
	Lender's coverage	Y	Varies	Varies
	Owner's coverage	Y	Varies	Varies
1200	Government Recording and Transfer Charges			
	Recording fees			
	Deed	Y		X
	Mortgage	Y	X	
	Releases	Y	X	
	City/County tax/stamps			
	Deed	N/A		
	Mortgage	N/A		
	State tax/stamps			
	Deed	Y		X
	Mortgage	Y	X	
1300	Additional Survey Charges			
	Survey	Y	X	
	Pest Inspection	Y		X

Table 2
Summary of Costs From HUD Housing Market Conditions Report on Closing Costs
Spring 2000

(Median priced home in study valued at \$85,000)

	<u>Paid By Buyer</u>		<u>Paid by Seller</u>	
	<u>Median \$</u>	<u>%</u>	<u>Median \$</u>	<u>%</u>
700 Total Sales/Broker's commission			4,880	5.6%
800 Items Payable in Connection with Loan*	967	1.1%	861	1.0%
900 Items Required by Lender to be Paid in Advance	NA	NA	NA	NA
1000 Reserves Deposited with Lender	NA	NA	NA	NA
1100 Title Charges	562	0.6%	622	0.6%
1200 Government Recording and Transfer Charges	55	0.1%	170	0.3%
1300 Additional Survey Charges	125	0.2%	125	0.2%
	<u>1,709</u>	<u>2.0%</u>	<u>6,658</u>	<u>7.7%</u>

* This category may include items that are not appropriate for consideration under ss. 193.011(1) and (8)

Table 3
Preliminary Analysis
Typical Closing Costs for Commercial Property Sales

	Typically Paid by Buyer	Typically Paid by Seller	Typical Sellers Cost Based on \$500,000 Contract Price
Real Estate Brokers Commission		X	50,000
Items Payable in Connection with Loan	X		
Legal Fees	X	X	6,250
Documentary Stamp Taxes			
Deed		X	3,500
Loan	X		
Environmental Fees	X		
Appraisal Fees	X		
Title Insurance	X	X	1,000
Survey	X		
Total			60,750
Percent			12.2%