



P.E. Pennington & Co., Inc.
Property Tax Appeal Specialists
since 1988

"We focus on developing and maintaining lasting relationships with our clients, and provide fairly priced, high quality services delivered with credibility."

Legislative Updates

H.B. 438 – Property Taxes: does the following: (1) provides that the appraised value of a residence homestead may not increase more than ten percent in any single year.

H.B. 621 – Property Taxes: does the following: (1) enacts the "super freeport" property tax exemption that was approved by the voters in 2001 as an amendment to the Texas Constitution; (2) exempts from property taxes any tangible personal property (other than oil and gas, aircraft, dealer's motor vehicle inventory, dealer's boat inventory, dealer's heavy equipment inventory, and retail manufactured housing) that is located at a site for less than 175 days and is not under control of the property owner (unlike freeport goods--an exemption under current law--super freeport goods need not be shipped out of state in order to qualify for the tax exemption); (3) provides that a city may choose to opt out of the exemption by holding a hearing and then adopting an ordinance or resolution to continue taxing super freeport goods at a meeting held prior to January 1 of the first tax year in which the city wishes to continue taxing the goods.

H.B. 1210 – Property Taxes: does the following: (1) permits a city the option to extend, for good cause, the three-year deadline for a taxpayer to submit an application for a refund of overpayment or erroneous payment of property taxes; (2) provides that the extension may be for a two-year period, and (3) provides that an extension may not be granted for an overpayment caused by a change of exemption status or correction of a tax roll.

H.B. 3191 – Property Taxes: increases from 50 percent to 100 percent the property tax exemption for certain community housing development organizations (CHDOs) where the low-income dwellings are sold rather than rented

P.E. PENNINGTON & COMPANY, INC.
PROPERTY TAX CONSULTING
4300 Marsh Ridge Road, Unit 104
Carrollton, Texas 75010-4449
(972) 300-0580 Fax (972) 300-0586
Email: ppennington@pepennington.com

Concerned About Your Property Taxes? ...Let's Talk or Visit
www.pennin.com

The PROPERTY

TAXPAYERS' ADVOCATE

P.E. Pennington & Company, Inc.
20 Years of Providing Property Tax Solutions

Dallas, Texas

Published by P.E. Pennington & Company, Inc.

Vol. 18, 2007-2008

Est. 1988.

In This Issue...

"The DCAD 2007 Retail Revaluation"
by Paul Pennington.....Page 1
Legislative Updates.....Page 4

IMPORTANT UPCOMING TEXAS TAX DATES

FILING SUIT:.....Within 45 days of receipt of the
..... ARB Order Determining Protest
TAX RATES SET: Generally September-October
TAX BILLS MAILED: . Generally October-November
JANUARY: Assessment Date January 1
JANUARY 31:Last day for payment of taxes:
..... • before they become delinquent
..... • for property subject to litigation
..... • for property subject to protest
JANUARY 31:Last day to file motion to correct
.....an incorrect appraisal
APRIL 15: Rendition Due Date
TAX ROLL CERTIFICATION: Generally July-August

At P.E. Pennington & Co., Inc. we understand the challenges our clients face and we pride ourselves in providing expert property tax consulting services adapted to the business needs of our clients. The industries and services in which we specifically focus, but are not limited:

- Assisted living • Business Personal Property
- Fair and Equitable Appeals • Hospitality
- Industrial • Land • Litigation Support
- Multi-Family Housing • Office
- Property Tax Research • Retail

The DCAD 2007 Retail Revaluation

by Paul Pennington

In 2007 the Dallas Central Appraisal District (DCAD) reappraised its retail properties, which commonly resulted in valuation increases of 50% to 300%. Listed below is the apparent reasoning behind such an aggressive reappraisal. We will also analyze the DCAD conclusions and compare them to independent third party published studies. Additionally, we will address what the effects of such dramatic increases in the 2007 retail valuations had on tenants and property owners. Finally, we will discuss the measures a property owner took to limit their tax liability and to protect their tenants' from excessive property tax "pass-throughs".

The Revaluation:

DCAD determined that retail properties were under appraised and decided to reappraise them for tax year 2007. Based on data collected, and summarized in the DCAD 2007 Shopping Center Sales/Cap Rate Study (the study), property owners were notified of their 2007 proposed valuations.1 The study, which was obtained through a formal open records request, represents the source documentation of the Rates used by DCAD.

Chart 1

DCAD 2007 Shopping Center Sales/Cap Rate Study
(Assumed to be Class A Rates)

BC	Sale Date	Square Ft	Year Built	Sales Price	Cap Rate	Sale \$ PSF	Comments
36	02/05	22,496	2003	\$6,272,000	6.69	\$278.81	
35	06/06	26,418	1998	\$6,500,000	5.71	\$261.19	
36	09/05	171,028	1985/65	\$53,000,000	5.67	\$309.89	
36	04/05	133,088	1987	\$19,000,000	4.995		Two Story
36	10/06	134,953	1987	\$31,300,000	4.47	\$231.93	Income Is Actual
35	12/05	38,788	1999	\$14,000,000	7.1	\$360.94	
36	11/06	46.8	1999	\$9,500,000		\$202.99	
35	09/05	32,114	1999	\$7,100,000		\$221.09	
36	10/06	178,121	1983	\$6,700,000	4.33		80% Vacant At Sale
36	12/06	324,569	1952	\$42,400,000	4.92		
36	06	43,885	2005	\$13,600,000		\$309.90	
35	03/06	28,794	2005	\$3,640,000	6.59		Two Story
				Average	5.608333	\$272.09	
				Median	5.67	\$278.81	

Continued on Page 2

P.E. Pennington & Co., Inc. is a regional firm with expertise in all types of Commercial Real Estate, Residential Real Estate, Personal Property, Intangible Value and out source compliance needs.

www.pennin.com

P.E. PENNINGTON & COMPANY, INC.
PROPERTY TAX CONSULTING
4300 Marsh Ridge Road • Unit 104 • Carrollton, Texas 75010-4449
(972) 300-0580 • Fax (972) 300-0586
E-mail: ppennington@pepennington.com
Office Hours: 7:00 a.m. to 5:00 p.m. Monday – Friday

P.E. Pennington & Company

Chart 2

Big Box Retail

BC	Sale Date	Square Ft	Year Built	Sales Price	Cap Rate	Sale \$ PSF	Comments
36	05/05	233,667	1987	\$22,785,202	6.29	\$97.13	All Big Box
36	04/06	140,934	1985	\$14,091,791	6.87	\$100.00	80k + SF Big Box
36	02/06	121,369	1986	\$11,500,000	5.9	\$94.75	50% Big Box/Theater
36	09/05	92,27	2003	\$16,232,750	4.995	\$175.93	Mostly Big Box
36	04/06	69,09	1995	\$8,265,856	4.47	\$119.54	95% Big Box
				Average	6.353333	\$117.49	
				Median	6.29	\$100.00	

Chart 3

Small Retail

BC	Sale Date	Square Ft	Year Built	Sales Price	Cap Rate	Sale \$ PSF	Comments
35	02/05	14,82	2003	\$3,325,000	4	\$224.36	
35	08/05	9,198	2001	\$1,930,000	7.49	\$209.83	Estimated Some Income Factors
35	06/05	11,879	1960	\$3,887,700	5.72	\$327.28	Estimated Some Income Factors
35	06/05	17,245	1995	\$3,050,000	4.995	\$176.86	
				Average	5.736667	\$253.82	
				Median	5.72	\$224.36	

Chart 4

Two Story Shopping Centers

BC	Sale Date	Square Ft	Year Built	Sales Price	Cap Rate	Sale \$ PSF	Comments
36	04/05	133,088	1987	\$19,000,000	4.995	\$142.76	Two Story
36	08/05	78,283	1981	\$12,000,000	7.49	\$153.29	Two Story
35	03/06	28,794	2005	\$3,640,000	6.59	\$126.42	Two Story
36	11/05	124,607	1983	\$12,500,000	4.995	\$100.32	Two Story
				Average	5.7925	\$130.70	
				Median	5.7925	\$134.59	

Analysis of the DCAD 2007 Shopping Center Sales/Cap Rate Study:

- The Appraisal District notes in the comments section that some of their Rates are based on actual and estimated income and expenses as well as profit and loss statements previously provided to DCAD presumably by the seller. Depending on the date of the sale the financial information DCAD had on file could be somewhat dated by the time of the transaction. This would have an effect on the indicated Rate.
- Additionally, one of the sales comparables was only 60% vacant at the time of sale.
- Some of the sales appear to be mixed use.
- Two of the sales comparables are repeated initially in the first group of sales comparables and again in the "Two Story Shopping Center's" grouping.
- A large number of the sales used in the DCAD study were transactions which occurred in 2005.

Conclusions of the DCAD 2007 Shopping Center Sales/Cap Rate Study:

- The Class A properties were selling on an average Capitalization Rate of 5.608%.
- Big Box Retail (Assumed to be Power Centers) were trading on an average Rate of 6.3533%.
- The average Rate on small retail averaged 5.736%.
- The Two Story Shopping Centers traded on an average Rate of 5.79%.

As a result of the DCAD Retail Study the commercial property tax department of DCAD generally used Rates of 6.0% for Class A, 6.5% for Class B and 8% for Class C properties.

Analysis:

Comparing the results of the DCAD 2007 Shopping Center Sales/Cap Rate Study with other published capitalization rate studies they appear to differ in their conclusions. Some Real Estate Professionals state that Dallas more or less mirrors national Rates. With that in mind, examining national Rates, using the First Quarter 2007 PriceWaterhouseCoopers Korpacz Real Investor Survey,² the following observations, Rate ranges and averages were concluded:

Chart 5

First Quarter 2007

PriceWaterhouseCoopers Korpacz Real Investor Survey National Regional Mall Market (First Quarter 2007)

"...investors note that cap rates as a whole are stabilizing – and even increasing for certain lower-class quality assets."

OVERALL CAP RATE (OAR)	CURRENT QUARTER	LAST QUARTER
Range	5.00%-9.50%	5.00%-9.50%
Average	6.89%	6.86%
Change (Basis Points)	-	+3

National Power Center Market (First Quarter 2007)

"...participants indicate that they (on average) are increasing and/or stabilizing in the national power market."

OVERALL CAP RATE (OAR)	CURRENT QUARTER	LAST QUARTER
Range	5.50%-9.00%	5.50%-9.00%
Average	7.28%	7.14%
Change (Basis Points)	-	+14

National Strip Shopping Center Market (First Quarter 2007)

"...many investors note overall cap rates are increasing (or at least stabilizing) in this market..."

OVERALL CAP RATE (OAR)	CURRENT QUARTER	LAST QUARTER
Range	5.80%-9.00%	5.80%-9.00%
Average	7.38%	7.27%
Change (Basis Points)	-	+11

The Korpacz Survey concludes that nationally with exception of California, Seattle and Phoenix, overall cap rates are increasing or stabilizing. Additionally, the average rates for Malls, Power Centers and Strip Centers have increased from the fourth quarter of 2006. Additionally, the average Rates from The Korpacz Survey are higher than the average rates used by DCAD on Class A and B properties.

In comparing The DCAD Study with the Henry S. Miller Commercial 2006-2007 Miller Mark (Miller Report),³ a Texas publication, we observe the following conclusions:

Chart 6

Henry S. Miller Commercial 2006-2007 Miller Mark (Miller Report)

PROPERTY TYPE	GOING-IN		STABILIZED		REVERSION	
	Average	Range	Average	Range	Average	Range
RETAIL	7.1%	6.5-8.0%	8.0%	7.0-10.0%	8.4%	7.0-12.0%

The Miller report notes that the Rates for class A, B, and C properties "Going-In Rates" were 7.1% and "Stabilized Rates" were 8.0%. In addition, they note that their Rates "...are more reflective of Class A type properties," and are broken out as follows: "Class A-44.6%, Class B-37.4% and Class C-18.0%". Miller also states that "...Approximately 76% of the respondents indicated that they deduct a reserve within their stabilized pro-forma." The DCAD study did not include recognition of reserves in determining their Rates.

The Miller Report acknowledges that property owners who reported their Rates (7.1% average), were made up of 82% of Class A and B retail properties. It would then stand to reason that the DCAD Rates (Rates of 6.0% for Class A, 6.5% for Class B, and 8% for Class C properties) would appear to be low. Thus both Korpacz and The Miller reports differ with the DCAD conclusions.

Why did the Korpacz Survey show an increase in Rates while the Miller report showed Rates lower than the previous year? The answer may be that The Korpacz Survey is reported on a quarterly basis and the Miller Report on an annual basis. Perhaps Korpacz was reflecting the beginning of the credit crisis. In June of 2007 Holliday Fernogolio Fowler, LP reported a dramatic downturn in the capital markets. In 2006 lenders were still bullish in their loan underwriting. For example; aggressive underwriting and loan structuring were still common. At the same time the subprime housing mortgage defaults exploded, the ripple effects spilled over into commercial real estate lending. By the first quarter of 2007 rating agencies began to scrutinize commercial mortgage-backed securities (CMBS) by tightening lending practices as protection against increasing loan defaults. As a result commercial

lending rates have risen over 100 basis points in the last twelve months. Rising interests rates typically translate into higher capitalization rates.

The Revaluation Effects:

To determine the effects of the 2007 DCAD retail revaluation one must first understand revenue recoveries also known as "pass-throughs." This term relates to an owner recovering expenses for common area maintenance (CAM) expenses, which include items such as utilities, security, cleaning, repairs, management fees and maintenance, etc. Additionally, landlords typically charge tenants for insurance and property tax reimbursements. "Pass-throughs" can vary based on the lease terms negotiated by the lessee. For example the terms could differ if the tenant is an anchor versus a non-anchor tenant.⁴

"Tenants are generally responsible to provide reimbursement for property taxes may include the costs of any protests or assessment appeal".... "The tenants will probably be required to pay their tax shares in advance on a monthly basis, adjusting for any differences at the end of the year".⁴

"Real estate taxes now make up about one-third of shopping center expenses..." The tenants are typically required to pay their tax shares in advance on a monthly basis, adjusting for any differences at the end of the year".⁵ Therefore, tenants have a vested interest in the amount of property taxes assessed due to the fact that they are required to reimburse their pro-rata share to the landlord.

According to Dollars & Cents of Shopping Centers/The Score 2006 6 the national averages of reimbursements are shown below as a comparison:

Chart 7

Number of Centers in Sample:244	Average Dollars per Square Foot of GLA	Median	Lower Decile	Upper Decile	Median Percent of Total Receipts	Lower Decile	Upper Decile	Number Reporting
OPERATING RESULTS								
TOTAL OPERATING RECEIPTS	\$12.78	\$12.55	\$6.02	\$21.75	100.00%	100.00%	100.00%	244
Total rent	10.19	10.27	5.08	16.75	80.03	69.83	88.01	242
Rental income-minimum	10.01	10.21	5	16.27	79.11	67.15	88.74	242
Rentia income-overages	0.45	0.28	0.04	1.48	2.59	0.22	10.19	59
Total common area charges	1.21	1.01	0.36	3.01	6.69	4.73	17.06	200
CAM administration fee	0.18	0.14	0.03	0.53	0.98	0.35	3.56	74
CAM charges (excluding administration fee)	1.13	0.96	0.35	2.8	7.97	4.48	16.98	196
Total other charges	1.32	1.25	0.44	2.73	9.80	5.28	16.32	185
Property taxes and insurance revenue	1.23	1.14	0.42	2.84	9.45	5.04	15.41	162
Property taxes revenue	1.03	0.94	0.29	2.16	7.86	3.49	13.71	195
Insurance revenue	0.17	0.15	0.04	0.34	1.25	0.40	2.48	157
Security revenue	0.14	0.11	0.02	0.32	0.59	0.22	3.65	14
Marketing/promotion fund (excluding merchants assn.)	0.28	0.22			1.20			8
Total HVAC energy revenue								3
Common area								3
Tenant space								2
Total other utilities	0.17	0.14	0.01	0.51	1.18	0.06	2.63	50
Common area	0.15	0.11	0.01	0.45	1.10	0.08	2.34	33
Tenant space	0.16	0.15	0	0.37	1.06	0.03	2.34	22
Other escalation charges								4
Total miscellaneous income	0.11	0.05	0.01	0.66	0.35	0.04	5.31	128

As we see from viewing Chart 7 above, nationally CAM reimbursements rank number one followed by property taxes and insurance respectfully. When we look at an actual Dallas neighborhood retail property after the 2006 revaluation and appeal (see below) we again see that the recapture of CAM, Tax, Insurance follow the national trends for neighborhood shopping centers.

Chart 8

	Total	Per Sq.Ft	Percent
Rental Revenue	\$492,552	\$15.70	62%
CAM Revenue	\$118,027	\$3.76	15%
Tax Revenue	\$160,302	\$5.11	20%
Insurance Revenue	\$11,178	\$0.36	1%
Other Revenue	\$13,310	\$0.42	2%
Total Operating Revenue	\$795,369	\$25.35	100%

It stands to reason that revenue and reimbursements fall within a definable range however they can be skewed by a variety of factors including, but not limited to, the property's occupancy level, tenants being current in rental payments, and lease terms of tenants. Typically we'd expect to see debt service being a property's largest expense and CAM and Taxes being the second and third highest expenses, which is clearly denoted in the two above mentioned examples (Chart 8 denotes a neighborhood retail center).

The next example below denotes the same Dallas property (Chart 8) after receiving their DCAD 2007 proposed valuation. As noted below the revaluation caused Tax Revenue to become the highest expense category even above CAM Revenue.

Chart 9

	Total	Per Sq. Ft	Percent
Rental Revenue	\$492,552	\$15.70	68%
CAM Revenue	\$118,027	\$3.76	16%
Tax Revenue	\$87,099	\$2.78	12%
Insurance Revenue	\$11,178	\$0.36	2%
Other Revenue	\$13,310	\$0.42	2%
Total Operating Revenue	\$722,166	\$23.02	100%

In the example above, the increase in recoverable tax revenue rose from \$2.78 to \$5.11 per square foot (p/s/f) which translates into an 83% increase. Typically, this increase would be paid by the tenant(s). The owner of this property is in a position of passing-through the large increase in tax revenue to the tenant(s). Although it can be argued that such a large increase would affect the tenant's future decisions to renew their leases at the subject property. Taken a step further, if such large recoverable tax pass-throughs affect tenant's willingness to renew their leases, two scenarios develop. First, tenant(s) might relocate to another property with lower property tax pass-throughs. Secondly, the landlord would have to make concessions in their rental rates to offset the increased expense to the tenant(s). Both scenarios would have a negative affect on the property's net operating income (NOI).

Taxpayers Rights:

When a property owner is faced with reappraisal of the magnitude described above they must first understand their rights.

A property owner is entitled to be assessed at market value based on methods that comply with the Uniform Standards of Professional Appraisal Practice and "... each property shall be appraised based upon the individual characteristics that affect the property's market value."⁷

The taxpayer is entitled to a fair and equitable appraisal based on the "...median level of appraisal must be prepared to prove unequal appraisal."⁸

To prove unequal appraisal, "A ratio study or a comparison of a representative sample of properties, appropriately adjusted, for determining the median level of appraisal must be prepared to prove unequal appraisal."⁹

Appealing:

With these rights in mind and facing a huge valuation increase, a property owner should consider dividing the appeal into two segments. First quantify the market value of the subject property and then address any issue relating to unequal appraisal.

The following is an example a Large Class A retail center initially assessed at \$48,000,000 in 2006 which was increased to \$78,649,800 for tax year 2007. The initial informal "Administrative Remedy" settlement meeting resulted in an offered reduction to \$69,000,000. The offer was rejected based on the fact that the owner believed that the property would still be appraised over market value. It was the decision of the property owner and their agent to commission a narrative fee appraisal to determine the subject's market value as of January 1, 2007. The appraisal report indicated a market value of \$55,000,000, which the DCAD Appraisal Review Board (ARB) certified as correct. This appeal effectively reduced the proposed 2007 appraised value from a potential increase of 63% to 16.6%.

The tenants of this property had been informed of the increased valuation which would affect their accruals for the property tax pass-throughs, they were also advised of the successful market value appeal. Additionally, the property owner has left open the possibility of appealing the ARB rulings if an unequal appraisal exists. If an unequal appraisal does exist a successful appeal would translate into additional relief to the tenants.

References:

- The DCAD 2007 Shopping Center Sales/Cap Rate Study.
- First Quarter PriceWaterhouseCoopers Korpacz Real Investor Survey
- Henry S. Miller Commercial 2006-2007 Miller Mark
- P. (203-206 and 214) Shopping Center Appraisal and Analysis; Vernor and Rabianski
- P. 218 Shopping Center Appraisal and Analysis; Vernor and Rabianski
- Dollars & Cents of Shopping Centers/The Score 2006, p 226.
- Sec. 23.01 of the Texas Property Tax Code
- Sec 42.26 of the Texas Property Tax Code
- Texas Property Taxes, Taxpayer's Rights, Remedies and Responsibilities, February 2007