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VOLUME 3 – LAND VALUATION MANUAL

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ADDENDUM 3-B, NON-QUALIFYING SALES

The following is a list of real estate sales for which documentary fees are required. If, through analysis, they have been determined to be non-arm's-length sales, they can be coded as non-qualifying. Non-arm's-length sales generally should not be used in market analysis. Non-arm's-length sales should never be used in statistical analysis or to establish values.

Also shown are the associated codes that should be used to identify such sales on the master sales list. These sales will not be shown on the qualified list and, therefore, will not be used in determining values.

<u>Assigned Code</u>	<u>Documented Reason</u>
51	Sale involves a government agency as the buyer
52	Sale involves a public utility
53	Sale involves a charitable institution
54	Sale involves a religious institution
55	Sale involves an educational institution
56	Sale involves a financial institution as the buyer
57	Sale is between related parties
58	Sale is between business affiliates
59	Sale is to correct defect in title
60	Sale is to settle an estate
61	Sale results from judicial order or decree
62	Sales of doubtful title, e.g., quitclaims
63	Sale involves property trades
64	Sale involves multiple properties
65	Sale involves unfulfilled agreements for which no market value can be determined
66	Sale involves non-realty items of an undeterminable value
67	Sale includes a franchise or license of unknown value
68	Sale not verified before extensive remodeling or building of additional improvements or change in use
69	Sale of a partial interest, i.e., less than 100 percent of fee simple interest, in the property
70	Other _____

Note: Sales disqualified under #70 must be extensively documented as to the reason the sale has been determined non-arm's-length.

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Colorado State Forest Service Requirements

The forest management plan may be prepared by any designated professional forester; however, it must be reviewed and receive a favorable recommendation from the Colorado State Forest Service (CSFS).

- The CSFS must also annually inspect each parcel of land subject to a forest management plan to determine if the terms and conditions of the plan are being complied with.
- A service fee is charged to the landowner for the annual inspections and any other work performed, e.g., development of a plan or timber cruising.

PERPETUAL CONSERVATION EASEMENTS

If land that is currently classified as agricultural and acquires a conservation easement , it will remain agricultural for property tax purposes if it meets the following criteria as allowed in § 39-1-102(1.6)(a)(III), C.R.S.

- It is land that is at least 80 acres if it contains any residential improvements, or it may be any size if it does not contain residential improvements, and
- That is subject to a perpetual conservation easement, and
- If the land was classified by the assessor as agricultural land at the time the easement was granted, and
- If the grant of the easement was to a qualified organization, and
- If the easement was granted exclusively for conservation purposes, and
- If all current and contemplated future uses of the land are described in the conservation easement.
- It does not include any portion of the land used for nonagricultural, commercial, or residential purposes

"Conservation purpose" as defined by § 39-1-102(3.2), C.R.S., means the preservation of land areas for outdoor recreation, the education of the public, or the protection of a natural habitat for fish, animals or plants; or the preservation of open space for the scenic enjoyment of the public, or is pursuant to a government conservation policy where such preservation will yield a significant public benefit.

"Perpetual conservation easement" as defined by § 39-1-102(8.7), C.R.S., means a conservation easement in gross as described in article 30.5 of title 38, C.R.S., that qualifies as a perpetual conservation restriction under section 170(h) of the federal Internal Revenue Code of 1986.

A "qualified organization" as defined by § 39-1-102(13.2), C.R.S., is one that is exempt from federal income tax within the meaning of the federal Internal Revenue Code of 1986, Section 170(h)(3). Examples are government agencies such as the Colorado Division of Wildlife, or nonprofit land trusts such as the Nature Conservancy, American Farmland Trust, and Wilderness Land Trust.

Agricultural land that becomes subject to a perpetual conservation easement shall continue to be valued as agricultural notwithstanding its dedication for conservation purposes; except that, if any portion is used for nonagricultural commercial or residential purposes, that portion shall be valued according to such use, as required by § 39-1-103(5)(a), C.R.S. The land shall continue to be valued at the agricultural land value rather than at market value except for any land that is actually used for nonagricultural commercial or residential uses.

When a perpetual conservation easement has been terminated, violated, or substantially modified so that the easement is no longer used exclusively for the conservation purposes stated in the easement, the assessor may reassess the land retroactively for a period of seven years and the additional taxes, if any, that would have been levied on the land during the seven year period shall become due, as allowed by § 39-1-103(5)(d), C.R.S.

The intent of these statutes is twofold. First, they are intended to encourage those agricultural land owners choosing to preserve the open character of their land rather than allowing it to be developed for other purposes. Second, they are intended to ensure that those owners who preserve their land by means of a perpetual conservation easement, and their heirs, will benefit from low property taxes whether the land is used for agricultural purposes or only for the conservation purposes permitted by the conservation easement.

A perpetual conservation easement outlined in § 39-1-102(1.6)(a)(III), C.R.S., is not to be confused with the *Conservation Easements in Gross* topic found later in this section.

DECREED WATER RIGHTS

A fourth category of land to qualify as agricultural land is described in § 39-1-102(1.6)(a)(IV), C.R.S. The qualifying criteria include the following.

- The land must be used as a farm or ranch on the assessment date, and
- The owner of the land must have a decreed right to appropriated water granted in accordance with article 92 of title 37, C.R.S., or
- A final permit to appropriated ground water granted in accordance with article 90 of title 37, C.R.S., and
- The water must be for purposes other than residential purposes, and
- The water appropriated must be used for the production of agricultural or livestock products on the land.
- If the criteria are met, the land will qualify the first year of use as a farm or ranch.

Even though the “used the previous two years plus current” provision pursuant to § 39-1-102(1.6)(a)(I), C.R.S., does not apply to this category, the property must be used as a farm or ranch on the assessment date and have a documented decreed water right in order to receive the agricultural designation.

Because both land and improvement(s) of a condominium, timeshare, or undivided interest project are valued as a unit using the three approaches to value, the calculation is based on the projected taxes paid if the residential assessment rate was applied to the unit versus if the nonresidential assessment rate of 29 percent is applied.

For additional information regarding this requirement, refer to **ARL Volume 2, ADMINISTRATIVE AND ASSESSMENT PROCEDURES MANUAL, Chapter 6, Classification Guidelines and Assessment Percentages.**

CONDOMINIUM CONVERSION PROCEDURES

The Dictionary of Real Estate Appraisal- 4th Edition defines “Condominium Conversion” as “Conversion of rental properties, e.g., residential, commercial, office, or industrial buildings, into condominium ownership.”

If a condominium conversion is created during an even numbered year (intervening) so that it is in existence on January 1 of an odd numbered year (revaluation), it is listed, appraised and valued for assessment the same as a new condominium ownership under § 39-1-105, C.R.S. (assessment date) and § 38-33-104, C.R.S. (assessment of condominium ownership). That is, the units are listed separately on the records of the assessor, and, the individual units are valued to the applicable level of value by the appropriate consideration of the cost, market, and income approaches to value.

If a condominium conversion is created during a revaluation year, so that it is in existence on January 1 of the intervening year, Colorado has specific law relating to the valuation of a conversion of a multiple-unit building into condominium ownership. It is included in the “unusual condition” portion of statute, § 39-1-104(11)(b), C.R.S.:

(II) The creation of a condominium ownership of real property by the conversion of an existing structure shall be taken into account as an unusual condition as provided for in subparagraph (I) of this paragraph (b) by the assessor, when at least fifty-one percent of the condominium units, as defined in section [38-33-103](#) (1), C.R.S., in a multiunit property subject to condominium ownership have been sold and conveyed to bona fide purchasers and deeds have been recorded therefore.

The statute specifies that in order to change the valuation method from the previous single ownership fee simple to valuing the condominium units on an individual basis, the following conditions must be met:

- Fifty-one percent (51%) or more of the units must be sold
- The units must be conveyed to bona-fide purchasers
- The deeds must be recorded

It may be helpful to note that:

- The units do not have to be in a single structure;
- Use is not part of the criteria; it may be single or mixed use;
- There is no distinction as to what type of building may be converted. It could be residential, office, commercial, industrial, or mixed use, or any other type of condominium conversion that may exist.

Because the above citation is from the unusual condition portion of statute, its application is **only** in an intervening year as shown below:

Example #1

A building was converted to condominium use during a revaluation year but had not achieved the 51% sellout threshold on January 1st of the intervening year. In order that any sold units would receive a proper tax billing, the individual units would be listed separately on the assessor's records and tax warrant roll. However, it would continue to be **valued** as an apartment, office, or industrial use at its, bulk value for the intervening year. That value would be apportioned to the individual units.

On January 1st of the subsequent year, and for every year thereafter, the property would be valued on an individual condominium basis with no discount, regardless of how many of the units had been sold.

Example #2:

A fifty-unit apartment complex was converted to condominium use on August 30th of a revaluation year. The apartment complex has an overall value of \$2,500,000 for the single tax schedule number. Twenty-four units have been sold to bona-fide purchasers and their deeds recorded by January 1st.

Because the 51% threshold has not been met, the \$2,500,000 must be allocated among the fifty units.

In the subsequent year, and every year thereafter, the assessor should value the units on an individual condominium basis.

Example #3:

The same fifty unit apartment building mentioned above was able to sell, close and record the twenty-fifth and twenty-sixth units. It now exceeds the 51% threshold. All fifty units must be valued as individual condominiums.

GENERAL VALUATION PROCEDURES

Condominiums, timeshares, and undivided property interest units that are excluded from the definition of hotel or motel properties pursuant to § 39-1-102(5.5), C.R.S., are valued through appropriate consideration of the cost, market, and income approaches to appraisal. All land and improvement(s) of a condominium, timeshare, or undivided interest project are valued as a unit. Once the overall value of the project is established, determination of residential and nonresidential property classification occurs.

If the project has one or more units or other portions of the project that cannot be classified as residential, then the project is classified as a mixed-use property. The **residential** portion of the mixed-use property includes the units owned by developer, or lender, or owner's association if acquired pursuant to foreclosure or other similar transaction, and any part of the project dedicated solely for the use of the residential unit owner. The **commercial** portion is all other property in the project not classified as residential.

Calculation of the NPV Conversion Rate

For purposes of the procedures, a NPV conversion rate is used to determine the appropriate present worth of one factor that is applied to the estimated payments for each year remaining in the agreement to arrive at a present value of the possessory interest. The NPV conversion rate consists of an appropriate discount rate and the effective tax rate.

$$\begin{array}{r}
 \text{Discount Rate} \quad \text{(calculated by the county)} \\
 + \text{ Effective Tax Rate } \quad \text{(calculated by the county)} \\
 \hline
 \text{NPV conversion rate}
 \end{array}$$

The assessor may round up the NPV conversion rate to the next highest half percent. For example, a discount rate of 12.32 percent may be rounded to 12.5 percent. Rounding the discount rate will allow counties without access to a financial calculator or spreadsheet program to use published present worth of one (or present worth of one per period) tables to determine the appropriate conversion factor or factors.

Present Worth of One Factor Application

After the NPV conversion rate is determined, the applicable Present Worth of One factor from the compound interests tables is applied.

The calculation must be done for each year remaining in the initial term of the lease. The calculation can be done on a financial calculator or as a formula used in a computer spreadsheet program.

If review of the payment amounts over the remaining term of the agreement indicates that the payment will be identical for each year, use of a present worth of one per period factor based on the conversion rate and remaining years may be used in place of the present worth of one factor.

Level of Value Adjustment Factor

Pursuant to § 39-1-103(17)(a)(I) and (II)(B), C.R.S., the administrator is required to establish the level of value (LOV) adjustment factor(s) for possessory interests using the same procedures and principles as are provided for property in § 39-1-104(12.3)(a)(I), C.R.S. For each assessment year, the Division of Property Taxation publishes separate LOV adjustment factors for real and personal property possessory interests.

For each tax year, the Division utilizes the U.S. Department of Labor, Bureau of Labor Statistics data changes to the CPI-U: Denver- Boulder-Greeley from appraisal date to assessment date to calculate the LOV factor.

The factors are derived as follows:

1. For real property, the factor is based on median changes to the Western District averages for real property construction costs between the June 30 appraisal date and the January 1 assessment date as reported in Section 98, page 7 of the Marshall and Swift Valuation Manual published by the Marshall Valuation Service.
2. For personal property, the factor is based on median changes in the equipment cost indexes from the "Average of All" industries category between the June 30 appraisal date and the January 1 assessment date as reported in Section 98, page 7 of the Marshall and Swift Valuation Manual published by the Marshall Valuation Service.

STEPS TO VALUE COMMERCIAL POSSESSORY INTEREST

As required by § 39-1-103(17)(a)(II), C.R.S., the actual value of commercial possessory interests is determined by the present value of the reasonably estimated future annual rents or fees required to be paid by the holder of the possessory interest to the owner of the underlying real or personal property through the stated initial term of the agreement.

Steps in the valuation process:

STEP #1 Contact the appropriate federal, state, or local agency or entity to obtain information regarding the agreement.

Use the list provided by the Division for the federal and state agencies. The items on the list include names, mailing addresses, annual payments, terms and the original date and/or the expiration date of the agreement. If you have any questions regarding information contained on the list, refer to *Discovery of Possessory Interests* for the name, address, and phone number of the applicable agency.

In the event that property owned by a governmental entity other than federal or state land is used for commercial purposes by a private party, the county is responsible for obtaining the necessary documentation.

STEP #2 Develop the applicable NPV conversion rate.

Calculating the applicable net present value conversion rate:

$$\begin{array}{r}
 \text{Discount Rate} \quad \quad \quad (\text{calculated by the county}) \\
 + \text{ Effective Tax Rate } \quad (\text{calculated by the county}) \\
 \hline
 \text{NPV Conversion Rate}
 \end{array}$$

For additional information regarding how discount rates for commercial possessory interest properties are developed, refer to *Development of the Discount Rate for Commercial Possessory Interests*. For the formula used in calculating an effective tax rate, refer to *Development of the Effective Tax Rate*.

STEP #3 Determine the present worth of one factor.

For each year remaining in the agreement, determine the appropriate present worth of one factor in the compound interest tables based on the net present value conversion rate previously established by the county.

For possessory interests that have a duration of one year or less, the payment is the present worth.

STEP #4 Calculate the present value of the payments over the remaining years in the initial term of the agreement.

Conversion of the annual payments to present value is calculated by multiplying each year's payment by the applicable present worth of one factor based on the previously determined NPV conversion rate. The calculation is completed for each of the remaining years in the initial term of the agreement. Add each year's present value together for the total NPV of the possessory interest.

Example calculation of a commercial possessory interest:**Assumptions:**

- Remaining years of income stream 4 years
- Net present value conversion rate including ETR 14%
- Annual payment (less exclusions) for remaining years in the agreement

Year #1	\$10,000
Year #2	\$11,000
Year #3	\$12,000
Year #4	\$13,000

Calculation of NPV:

	Year #1	Year #2	Year #3	Year #4
Annual payment (less exclusions)	\$10,000	\$11,000	\$12,000	\$13,000
PW of 1 Factor for 14%	<u>.877193</u>	<u>.769468</u>	<u>.674972</u>	<u>.592080</u>
Net Present Value of payment	\$ 8,772	\$ 8,464	\$ 8,100	\$ 7,697
TOTAL NPV of the Possessory Interest				<u>\$33,033</u>

The net present value for each remaining year in the agreement is totaled to arrive at the NPV of the possessory interest. Simply stated, \$33,033 is the value today of the total payments over the remaining years in the agreement.

The Division developed an electronic spreadsheet that may be used to determine the present value of the payments over the remaining years in the agreement. Please contact the Division for an electronic copy of the spreadsheet.

STEP #5 Apply the level of value adjustment factor published by the Division.

The calculation of the actual value of the possessory interest is:

$$\frac{\text{NPV of the possessory interest} \times \text{Level of value adjustment factor (published by the Division)}}{\text{Actual value of the possessory interest}}$$

AGRICULTURAL POSSESSORY INTEREST VALUATION

Land owned by a governmental entity and used through an agreement for farming or ranching by a private individual is a taxable possessory interest. Agricultural possessory interests are valued in accordance with § 39-1-103(17)(a)(II), C.R.S. Senate Bill 04-059 established, as of January 1, 2005, that the actual value of a possessory interest in agricultural land, including land leased by the state board of land commissioners other than land leased pursuant to § 36-1-120.5, C.R.S., shall be the actual amount of the annual rent paid for the property tax year.

Data Needed

- Actual rent paid in the agreement

Obtaining Necessary Information

For information on how to contact the respective agency for a list of necessary information for use in classification and valuation of possessory interests, refer to *Discovery of Possessory Interests*.

Level of Value Adjustment Factor

Pursuant to § 39-1-103(17)(a)(I) and (II)(B), C.R.S., the administrator is required to establish the level of value adjustment (LOV) factor(s) for possessory interests using the same procedures and principles as are provided for property in § 39-1-104(12.3)(a)(I), C.R.S. For each assessment year, the Division of Property Taxation publishes separate LOV adjustment factors for real and personal property possessory interests.

For each tax year, the Division utilizes the U.S. Department of Labor, Bureau of Labor Statistics data changes to the CPI-U: Denver- Boulder-Greeley from appraisal date to assessment date to calculate the LOV factor.

The factors are derived as follows:

1. For real property, the factor is based on median changes to the Western District averages for real property construction costs between the June 30 appraisal date and the January 1 assessment date as reported in Section 98, page 7 of the Marshall and Swift Valuation Manual published by the Marshall Valuation Service.
2. For personal property, the factor is based on median changes in the equipment cost indexes from the "Average of All" industries category between the June 30 appraisal date and the January 1 assessment date as reported in Section 98, page 7 of the Marshall and Swift Valuation Manual published by the Marshall Valuation Service.

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