

A Reprint from *Tierra Grande*

# Protesting Makes Cents Lowering Property Tax Assessments

By Charles E. Gilliland



**If the word “protest” makes you think of angry, placard-carrying mobs confronting police in riot gear, crank your imagination down a few notches. Think instead of business owners peacefully protesting their property tax assessments in an effort to minimize their property tax liabilities.**

**T**he Texas Property Tax Code allows businesses and individuals to protest property valuations they consider inaccurate. Most businesses that take advantage of the protest process do so to correct clerical errors or to document physical deterioration that lowers a property’s market value.

While physical deterioration is important, other factors may have a greater impact on value. Negative environmental factors and design flaws, for example, often go unreported or are inadequately described in a protest or appeal. Appraisers routinely identify these influences as *obsolescence*, which can be either *external* or *functional* depending on the source of the problem. To convey the importance of these negative influences, business owners must describe the problems in detail and convincingly quantify their effects on the property’s value.

## External Obsolescence

External obsolescence arises from factors beyond the owner’s control, such as negative environmental influences. Negative effects can be direct, like pollution-producing neighboring properties, or indirect, such as too many suppliers of a particular product or service in the area. In most business settings, external obsolescence results in lost property income, which in

turn reduces market value. Standard cost-based tax appraisals seldom adjust for this kind of devaluation.

For property to be assessed at a lower taxable value, the owner must convince the local appraisal district that the property’s value suffers from a negative external influence. If the problem stems from a neighboring property, the owner must clearly describe the problem and offer evidence to substantiate a lower value.

Visual evidence such as photos can dramatically convey the nature and extent of problems. Any available statistical evidence on income loss or overcapacity in the market can bolster the case. Facts and figures in chart or graph format are effective. After establishing external obsolescence, the owner must provide an objective estimate of its effect on the property’s value.

## Functional Obsolescence

Functional obsolescence results from flaws within a property that limit its market appeal. Defects become apparent when the property is compared with other properties of the same type. Buildings that have been converted from one use to another frequently suffer from functional obsolescence.

Buildings that were state of the art when they were constructed frequently suffer obsolescence as new designs and technologies emerge. Buyers are unwilling to pay as much for older properties as they would for modern, fully equipped facilities.

Functional obsolescence can stem either from *deficiencies* or *superadequacies*. Lack of central air conditioning in an office building is an example of a functional deficiency. A large atrium in an office building is an example of a superadequacy, an expensive addition not present in more typical, cost-efficient properties. Superadequacies diminish property value by reducing market appeal, resulting in lower net income and a lower market value.

This particular superadequacy reduces value in two ways. First, a modern office building would not have the large atrium, which is unrentable square footage. The difference between the cost of constructing the building with the large atrium and that of building a modern replacement without a large atrium is an excess cost. When this excess cost is included in an appraisal, it adds to the property's valuation without producing any offsetting income.

Second, the superadequacy raises operating costs because the unrentable space in the atrium must be heated and cooled. A modern building with the same amount of rentable space and a standard entry would not require this expenditure. Maintenance of the unrentable space further reduces the cost-derived value estimate. Presumably, potential buyers would factor this into their offers.

## Estimating Obsolescence

Both external and functional obsolescence reduce property net income. Documenting the negative effects of obsolescence helps property owners measure the dollar amount of value lost to obsolescence. Once the amount of net income loss suffered because of an obsolescent feature is determined, that figure can be used to quantify obsolescence for the local appraisal district.

For example, a poorly designed workspace that results in diminished productivity will result in deficient output. Property owners can demonstrate such inefficiency using a statistical analysis of typical industry income standards for that kind of business operation. By converting the difference between actual income and typical income into an estimate of income shortfall, the owner can quantify how much a poor design has reduced the value of the property.

Property tax deductions for obsolescence are subject to limitations. If a deficiency can be rectified by remodeling the property, the deduction for obsolescence cannot exceed the remodeling cost. For example, suppose a property contained an old-fashioned single-compartment sink instead of a double-compartment sink, which is now the standard. The owner could eliminate the deficiency by replacing the sink with a

modern one. The cost of purchasing and installing that new sink is the figure used to measure obsolescence if that cost is less than the *capitalized income loss* (the present value of expected annual losses over the life of the investment). However, if the cost of correcting the deficiency exceeds the capitalized income loss, the deficiency is considered incurable, and the amount of capitalized income loss is the figure to present to the appraisal district as evidence of overvaluation.

If functional obsolescence is caused by the absence of a feature that is standard in comparable properties, measuring obsolescence becomes more complicated. In the sink example, an existing but deficient feature was replaced with its modern equivalent. If the feature had been missing entirely, adding it would represent an *improvement* to the existing property, not a remedy for obsolescence. Because

current value is based on the existing property in its current configuration, the cost of adding a missing element cannot be used effectively to argue that a property has been valued incorrectly.

When a feature is added to a property to remedy obsolescence, the cost of installing it during construction of a similar new building is subtracted from the estimated cost of adding it to the existing building. That difference is a measure of obsolescence. For example, suppose a property is cooled with floor fans whereas the standard building has central air conditioning.

Adding central air to this existing facility will cost more than building it into a new structure because ducts and wiring must be added to the existing structure.

In this case, obsolescence would be quantified as the cost of adding central air to the deficient building minus the cost of including central air in a comparable new building. If that figure is less than the capitalized income loss, the property owner could request that the property appraisal be reduced by that amount.

Once obsolescence is established, the tax savings realized in the first year should continue each year for as long as the problem exists. These tax reductions may represent substantial savings for property owners.

The examples used in this article are simplified but illustrate the complicated nature of estimating obsolescence. Although property owners may easily identify obsolescence, quantifying value loss can be both difficult and time consuming. However, given current property tax rates, the amounts at stake may be substantial. Owners may find it cost effective to engage property tax and valuation experts to assist in developing a convincing case.

For more complete information about estimating obsolescence, see *The Appraisal of Real Estate: Twelfth Edition* published by the Appraisal Institute. 📌



**OBSOLESCENCE CAN BE BEAUTIFUL**, as in this oversized lobby. But costs to maintain such nonincome-producing space are significant.



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