P H C R E N E W S L E T T E R

POPP | HUTCHESON PLLC

The Property Tax Firm

CRE Quarterly

A Quarterly Newsletter

Issue No 1 - Spring 2013

Letter from the Editor

Dear Readers,

Popp Hutcheson, PLLC is proud to publish our first issue of *Commercial Real Estate Quarterly.* We hope that *CRE Quarterly* will become instrumental in keeping you informed about the Texas property tax industry. In each issue, we will cover valuation issues, appraisal district updates, the Texas Legislature, and other industry topics.

In our inaugural issue's *Expert Opinion* article, we cover a changing market dynamic in cap rate spreads between different classes of shopping centers. The article illustrates how a recent shift in measuring risk between Class A centers and all other centers is widening to record levels, which may lead to overvaluation for Class B and C centers. Many thanks to our clients that helped contribute to the article, as it was their keen market insight that helped us publish this article in a recent edition of *Shopping Center Business.*

Following our *Expert Opinion* section we cover recent Popp Hutcheson events and announcements and provide a timely "Texas Legislative Update." The 83rd Texas Legislature is in the midst of session and property taxes are once again at the forefront of many bills working their way through the political system. Our link in this section will take you to detailed highlights surrounding pending property tax legislation.

Notices of appraised value are arriving in Texas mailboxes daily. In reviewing the first notices released for 2013, it appears that appraisal districts are intent on chasing the current market recovery. We are seeing some drastic increases in value over 2012 valuations, which will certainly lead to a record number of protests for many counties. Remember, the protest deadline to appeal your 2013 Notice of Appraised Value in Texas is May 31st or 30 days from your notice, whichever is later.

We hope you enjoy Popp Hutcheson's CRE Quarterly, and we welcome your feedback as we fine-tune the next few issues. Click **here** to share your thoughts with us.

- PH Editor

Changing Cap Rate Spreads May Inflate Property Taxes

EXPERT OPINION

by Mike Shalley

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A scarcity of comparable sales data is driving many property tax assessors to rely instead upon historical rules of thumb that may threaten inflated tax bills for shopping center owners. To understand the problem, however, requires a clear understanding of the events that have weighed down transaction volume, how mass appraisal software works, and how extrapolations from the few property sales available today can lead appraisers astray.

A recipe for confusion

The recent credit crunch may be regarded as one of the worst in American history. The crisis hit hard in March 2008, as investment bank Bear Sterns became the first of dozens of major American financial institutions to fail or be bailed out by the Fed. The causes were many starting with subprime mortgages and extending to consumer credit, commercial mortgage backed securities and credit default swaps. But one of the greatest impacts for the commercial real estate market came in the form of uncertainty regarding property values and future access to credit.

This vast uncertainty that followed the crisis halted or cratered most transactions in commercial real estate, making it almost impossible to accurately appraise property and peg asset prices. Appraisers and property tax assessors struggled to find comparable sales, and many times looked back to historical rules of thumb to extrapolate data gathered from a few current sales for application in a wide range of assessments. It is the use by property tax assessors of these old standards in mass appraisal valuation models that may overburden some property owners.

Accurate capitalization or cap rates (the ratio between the annual net operating income of an asset and the capital cost or market value) enable an appraiser or investor to calculate an asset's value from its net operating income. So an assessor who knows the cap rate from a recent property sale can use that data in assessing similar properties.

In normal and functioning commercial real estate markets, the spread in capitalization rates between Class A, B and C properties has generally held a consistent range. Historically, the variance or spread in cap rates between Class A or investment-grade properties and Class

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There has been a flight to quality

among investors and well-leased Class A shopping centers' cap rates are getting really aggressive. On the other hand Class B and B-minus centers have to be priced very attractively for us to even look at them.

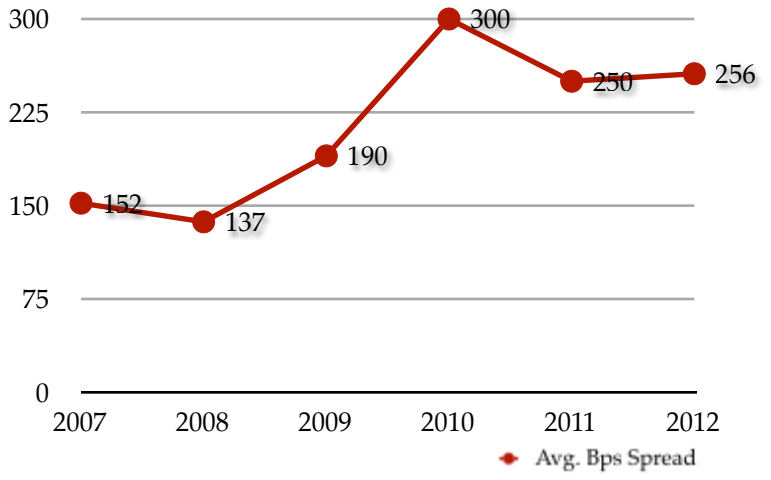
- Rafi Zitvar, Global Fund Investments LLC

B properties typically averaged between 75 basis points and 150 basis points.

A similar cap rate spread existed between Class B and C properties. However, these old rules of thumb have become at least temporarily obsolete.

"There has been a flight to quality among investors and well-leased Class A shopping centers' cap rates are getting really aggressive," says Rafi Zitvar, a principal at Global Fund Investments LLC, which specializes in retail real estate. On the other hand, "Class B and B-minus centers have to be priced very attractively, say 200 to 300 basis points above Class A centers, for us to even look at them."

Avg. Overall Cap Rate Spread between Institutional and Non-Instutional Strip Shopping



SOURCE:PriceWaterhouseCoopers

The PWC Real Estate Investor Survey - compiled quarterly by PricewaterhouseCoopers and formerly known as the Korpacz Real Estate Investor Survey – reveals this widening trend for cap rates among asset classes in the National Strip Shopping Center category. The survey data confirms that the average cap rate spread between institutional grade and non-institutional grade properties has increasingly widened for the last six years (as shown in the chart on the left).

Modeling mishaps

Many property tax assessors use a mass appraisal income approach model that uses cap rates to assess shopping centers. The model breaks down various components of each shopping center that are usually predicated on the classification of the center. The rental income, expenses and a corresponding cap rate for each shopping center are driven by the class inputted into the valuation model. Cap rates for each classification of shopping center are calculated off a sliding scale, where the base rate is usually a Class A cap rate supported by a sale or sales in the market, and then all other classes are modeled out using a scale based on typical spreads.

It is the scaling or setting of cap rates for Class B and C shopping centers using a Class A cap rate which can result in overvaluation. Clearly, the cap rate spreads between the top-quality shopping center assets and other classes have significantly changed over the last few years. Therefore, when assessors use historical cap rate spreads between different classes of shopping centers, the mass appraisal model overvalues properties from all but the highest class. It takes some experience, diligence and a detailed understanding of the assessor's model to ensure that a shopping center is being accurately appraised using today's standards.

For more information on this article please contact Mike Shalley, mike.shalley@property-tax.com

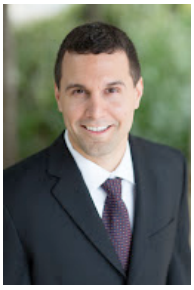
Popp Hutcheson Events and Announcements

PH Property Tax Seminar Recap

Popp Hutcheson recently hosted their annual Property Tax Seminar February 20 - 21, 2013 in their hometown of Austin, TX. The seminar was held at the AT&T Conference Center on the University of Texas campus and featured a variety of topics and speakers. James Canestaro, AIA, AICP spoke on "What Do Real Estate Valuation and Building Codes Have in Common." Representative Harvey Hilderbran - Chairman of the Texas House of Representatives Ways and Means Committee - gave the luncheon presentation, and Deborah Haskell, CRE, FRICS, MAI, from Cushman & Wakefield presented the US Real Estate Economic Outlook for 2013. Even Ken Nolan, Chief Appraiser of the Dallas Central Appraisal District, stopped by to give an overview of their "Methods and Assistance Program (MAP)." For further information on upcoming property tax seminars with Popp Hutcheson please contact Andrea Douglas at andrea.douglas@property-tax.com or 512-473-2661.

HANTX Property Tax Breakfast

The Hotel Association of North Texas (HANTX), with the help of Popp Huthcheson, hosted a member breakfast March 20, 2013 at the Hilton Dallas Park Cities. The topic of discussion was property tax appeals and litigation in Texas. The morning meeting included a presentation on unique laws and valuation issues that impact hotel property valuations in Texas, and a property tax outlook for 2013. For more information on HANTX, or their upcoming member events please visit their website at www.hantx.org.



New Hire, Kirk Garza

Popp Hutcheson PLLC is pleased to introduce our newest hire, Kirk Garza, MAI, to our Commercial Real Estate Team. Kirk received a B.S. from Texas A&M University in 2006, and graduated with a Master of Land Economics and Real Estate in December 2007. Prior to joining Popp Hutcheson, Kirk was a Senior Director for a privately owned commercial real estate appraisal company and was responsible for the valuation of various property types which included retail, industrial, multifamily, and office properties. Kirk is a Certified General Appraiser in Texas and recently became a designated Member of the Appraisal Institute. In his spare time, Kirk enjoys individual and team workouts with his local Crossfit Gym, and recently began learning the game of golf.

IPT's 2013 Annual Conference

Popp Hutcheson's Sebastian Rodrigano will speak at the upcoming Institute for Professionals in Taxation's Annual Conference in Orlando, FL, June 2013. Sebastian will present "US Shale Oil & Gas - Game Changer for US Manufacturing." His presentation will cover the underlying trends impacting energy prices, analyze how these issues impact the market value of industrial property, and will show how to incorporate these issues into the valuation of industrial property.

Read Our Latest Legislative Update

It is legislation time again in Texas and at the close of the filing period, over 276 property tax bills had been filed. About one-third of these bills relate to various exemptions, but historically very few exemption bills pass. Click **here** for a brief summary of selected bills of interest.