BEFORE THE DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 42.20.107 and 42.20.108 and the repeal of ARM 42.20.109 pertaining to the valuation of commercial properties	)))))	NOTICE OF PUBLIC HEARING ON PROPOSED AMENDMENT AND REPEAL

TO: All Concerned Persons

1. On July 1, 2024, at 11:00 a.m., the Department of Revenue will hold a public hearing in the Third Floor Reception Area Conference Room of the Sam W. Mitchell Building, located at 125 North Roberts, Helena, Montana, to consider the proposed amendment and repeal of the above-stated rules. The conference room is most readily accessed by entering through the east doors of the building.

2. The Department of Revenue will make reasonable accommodations for persons with disabilities who wish to participate in this public hearing or need an alternative accessible format of this notice. If you require an accommodation, please advise the department of the nature of the accommodation needed, no later than 5 p.m. June 14, 2024. Please contact Todd Olson, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-7905; fax (406) 444-3696; or todd.olson@mt.gov.

3. The rules as proposed to be amended provide as follows, new matter underlined, deleted matter interlined:

42.20.107 VALUATION METHODS FOR COMMERCIAL ~~PROPERTIES~~ PROPERTY (1) ~~When determining the market value of commercial properties, department appraisers will consider, if the necessary information is available, an income approach valuation.~~ The Uniform Standards of Professional Appraisal Practice (USPAP) and the International Association of Assessing Officers' (IAAO) standards for choice of valuation method guide the department's appraisal decisions. The final valuation method chosen is that which most accurately represents 100 percent of market value in accordance with 15-8-111, MCA.

(2) ~~When the department uses an appraisal method that values land and improvements as a single unit, the department shall establish a combined appraised value of land and improvements. The single unit value method includes, but is not limited to, the comparable sales method for residential condominiums and the income method for commercial property. The assessment notice must contain a single combined appraised value of the land and improvements.~~ When sufficient and relevant income and expense data is available, the income approach is the department's preferred valuation method for a commercial property, defined in 15-1-101, MCA. When income and expense data is not available, the department will use the cost approach. The department does not develop sales comparison market

models for commercial property but does consider comparable sales, if they exist, during the reconciliation and determination of final value.

~~(3) If the department is not able to develop an income model with a valid capitalization rate based on the stratified direct market analysis, the band-of-investment method, or another accepted method, or is not able to collect sound income and expense data, the final value chosen for ad valorem tax purposes will be based on the cost approach or, if appropriate, the market approach to value. The final valuation is that which most accurately estimates market value.~~

~~(4)~~ (3) ~~The International Association of Assessing Officers' (IAAO) standards for choice of method guide the department's appraisal decisions. The generally preferred method is the income method to valuation.~~ The department will document ~~in the official record the~~ its reason~~(s)~~ for choosing ~~an alternative method~~ the valuation method employed for a subject property.

AUTH: 15-1-201, ~~15-7-139,~~ MCA

IMP: ~~15-7-101, 15-7-102, 15-7-103,~~ 15-7-111, ~~15-7-139, 15-7-201, 15-44-103,~~ 15-8-111, MCA

REASONABLE NECESSITY: The department proposes numerous amendments to ARM 42.20.107(1), (2), (3), and (4), as a part of Governor Gianforte's Red Tape Relief Initiative, to simplify the administrative rule through the removal of redundancies to statute and clarification of department procedures and/or requirements.

The department proposes to amend the rule's catchphrase to remove the plural word "properties" in favor of the singular "property" for internal consistency to other department rules that employ references to singular versions (see, e.g., "individual").

The department proposes to relocate and revise the first sentence of current (4) to (1) for improved organization of content and explanation of department processes in valuation. The department also proposes to include cross references to 15-1-101 and 15-8-111, MCA, in (1) and (2), respectively, for necessary attribution to the periodic valuation cycles and the appraisal industry standards the department follows when completing its appraisals.

As an extension of the reorganized content in (1), the department proposes its amendments to (2) as more concise statements of valuation approach methodology.

Based on the extent and placement of the department's proposed amendments, it will be necessary for the department to renumber rule sections.

The department also proposes to strike 15-7-139, MCA, as an authorizing and implementing statute because the authority is unrelated to the rule. In addition, the department proposes to include 15-8-111, MCA, as an implementing citation for the cross-reference amendments proposed in (1) and (2) in accordance with 2-4-305, MCA.

42.20.108 MODEL DEVELOPMENT FOR THE INCOME APPROACH

(1) ~~The income approach is based on the theory that the market value of income-producing property is related to the amount, duration, and certainty of its~~

~~income-producing capacity. The formula used by the department to~~ When the department determines that the appropriate valuation method for appraisal of a commercial property is the income method, pursuant to ARM 42.20.107, then the department will estimate the market value of ~~income-producing~~ the property through application of ~~the~~ an income approach to value ~~is~~ formula, V = I/R, where:

(a) "V" is the market value of the property to be determined by the department;

(b) "I" is the ~~typical~~ property's net operating income (NOI) which shall reflect market rent~~s, not investment value income or other rents, for the type of properties being appraised~~ defined in (2); and

(c) "R" is the overall capitalization rate determined by the department as ~~provided in ARM 42.20.109~~ described in (6).

(2) For purposes of this rule, "market rent" ~~is the~~ means an amount of rent ~~that is~~ justified for ~~the~~ a property in an area which is based on ~~an~~ the department's analysis of comparable rental properties, and upon past, present, and projected future rent of the subject property. ~~It is not necessarily contract rent, which is the rent actually paid by a tenant~~ Additionally, the amount of rent paid by a tenant under a lease agreement is not solely determinative of market rent.

(3) ~~The department will periodically request gross rental income and expense information from commercial property owners. Standard forms, developed by the department, will be used to collect the information statewide. Additional methods of obtaining income and expenses information may consist of personal or telephone contacts with owners, tenants, renters, or lessees, knowledgeable lending institution officials, real estate brokers, fee appraisers, or any other sources the appraiser deems appropriate including summarized data from recognized firms who collect income and expense information, and appeal or court actions.~~ The department develops income models each valuation cycle based on its analysis of income and expense information voluntarily submitted from commercial property owners. Collected income and expense information is reviewed and analyzed to determine typical market conditions and an accurate estimation of gross rents, vacancy and collection losses, and operating expenses.

(a) Additional sources for income and expense information may include commercial property tenants, lending officials, brokers, fee appraisers, publications, informal reviews and formal appeals with property owners, or from any other source deemed appropriate and reliable in the appraiser's professional judgment.

(b) All income and expense data furnished by a property owner, or a property owner's agent, is kept confidential, as required by 15-8-120, MCA.

(4) Income models are for the following primary building types: apartments, hotels and motels, retail stores, restaurants, offices, warehouses, mini-warehouses, and mobile home/RV parks. The department may develop additional income models for other property types if sufficient income and expense information is available.

(5) The department establishes groupings for each primary building type by location, property characteristics (such as construction quality), building condition, building size, effective age, and by available income and expense information until a statistically significant number are available.

~~(4)~~ (6) ~~The department will review and analyze all annual rental income and expense data collected. As necessary, that data will be adjusted to reflect average~~

~~conditions and management before entering the data into the computer assisted mass appraisal system. The process must result in defensible estimates of potential gross rents, effective gross incomes, normal operating expenses, and normal net operating incomes.~~ The department develops an overall capitalization rate for determining market value of a commercial property.

(a) Commercial properties that are sold under valid, arms-length transactions are used to calculate an overall capitalization rate by dividing each property's net income by its adjusted sales price.

(b) The overall capitalization rate includes an effective tax rate (ETR). An ETR is calculated by multiplying a property's millage by its nominal tax rate to estimate the portion of the overall capitalization rate allocable to property taxes.

(i) In mass appraisal, property taxes are treated as a component of the overall capitalization rate rather than as an allowable expense.

(ii) Since market value is a component of calculating property taxes, utilizing ETR eliminates estimating property taxes before assessment is complete.

(c) Upon available data, overall capitalization rates and ETR are developed by primary building type, property location, or a grouping of property locations.

~~(5)~~ (7) ~~The department will follow established procedures for validating commercial sales information for the development of income models. Only valid sales will be used for the income and expense module of the computer assisted mass appraisal system.~~ Upon available data, the department may also develop a gross income multiplier (GIM) to value an apartment complex with eight units or less. A gross income multiplier factor is determined by dividing a property's valid sales price by its gross income, whether based on a monthly or annual period. The property's market value is then determined using the formula: value = gross income x GIM factor.

~~(6)~~ (8) ~~The department will use generally accepted procedures as outlined by the International Association of Assessing Officers in their text titled "Property Assessment and Appraisal Administration" when determining normal net operating income. The following is an example of the format that will be used:~~

~~(a) potential gross rent~~

~~(i) - vacancy and collection allowance~~

~~(ii) + miscellaneous income~~

~~(iii) = effective gross income~~

~~(iv) - normal operating expenses~~

~~(v) = normal net operating income.~~

~~(b) Normal and allowable expenses include:~~

~~(i) the cost of property insurance;~~

~~(ii) heat, water, and other utilities;~~

~~(iii) normal repairs and maintenance;~~

~~(iv) reserves for replacement of items whose economic life will expire before that of the structure itself;~~

~~(v) management; and~~

~~(vi) other miscellaneous items necessary to operate and maintain the property.~~

~~(c) Items that are not allowable expenses are:~~

~~(i) depreciation charges;~~

~~(ii) debt service;~~
~~(iii) property taxes; and~~
~~(iv) business expenses other than those associated with the property being appraised.~~

~~(d) An effective tax rate will be included as part of the overall capitalization rate.~~ Upon available data, the department may also develop a yield capitalization rate to determine market value. The yield capitalization rate will be determined using a return of investment (recapture rate), a return on investment (discount rate), and the ETR provided in (6)(b).

~~(7) Depending on data availability, the department may develop income models for various income use groups.~~

~~(a) Use groups may be, but are not restricted to:~~
~~(i) apartments;~~
~~(ii) hotels/motels;~~
~~(iii) general retail stores;~~
~~(iv) offices;~~
~~(v) regional malls;~~
~~(vi) multiuse offices;~~
~~(vii) warehouses/light manufacturing;~~
~~(viii) mini warehouses;~~
~~(ix) department stores;~~
~~(x) medical buildings;~~
~~(xi) auto service buildings;~~
~~(xii) manufacturing buildings;~~
~~(xiii) parking garages;~~
~~(xiv) multiuse sales;~~
~~(xv) banks;~~
~~(xvi) restaurants;~~
~~(xvii) storage buildings;~~
~~(xviii) apartment spaces in commercial buildings;~~
~~(xix) discount stores/super markets; and~~
~~(xx) franchise restaurants.~~

~~(b) Location groupings for each use type will be developed by combining the income and expense data in the following sequential order until a statistically significant amount of income and expense data and capitalization rate data is obtained:~~

~~(i) commercial intracounty neighborhoods as determined by the department to be economically and demographically homogeneous. In making the commercial neighborhood determinations, the department will consult with real estate and fee appraisal professionals; and~~

~~(ii) commercial intercounty neighborhoods the department determines to be economically and demographically homogeneous.~~

~~(c) The department may analyze the following information in addition to other appropriate information to ensure economic and demographic homogeneity:~~
~~(i) population;~~
~~(ii) employment;~~
~~(iii) income;~~

~~(iv) service availability and infrastructure;~~
~~(v) multiple listing service designations;~~
~~(vi) zoning and planning board designations;~~
~~(vii) proximity to employment/business centers; and~~
~~(viii) proximity to federal parks and reservations.~~
~~(d) The department may further group data based on the age of improvements if that is determined to be statistically significant.~~

AUTH: 15-1-201, MCA
IMP: 15-7-111, <u>15-8-111, 15-8-116, 15-8-120,</u> MCA

REASONABLE NECESSITY: The department proposes numerous amendments to ARM 42.20.108, as a part of Governor Gianforte's Red Tape Relief Initiative, to simplify the administrative rule content through the removal of redundancies to statute and clarification of department procedures and/or requirements.

The department proposes to amend the rule's catchphrase to improve accuracy of the scope of the rule's content.

The department proposes amendments to (1) to remove outdated, policy-related text from the rule in favor of more procedurally based text stated in a clearer and more concise manner.

Section (2) amendments propose to improve the market rent definition and clarify that market rent is not necessarily the amount of rent a property owner charges a tenant, which could be more or less than market rent.

Similar to the proposed amendments in (1), the department proposes to remove unnecessary text from (3) through (7) and amend the sections for improved organization and clarity of department processes in the development of income models for use in the income approach to valuation.

The department further proposes the inclusion of (3)(b) to implement new confidentiality requirements for income and expense data enacted by Senate Bill 62 (2023), codified as 15-8-120, MCA.

Based on the extent and placement of the department's proposed amendments, it will be necessary for the department to renumber rule sections.

Finally, the department proposes to add 15-8-111 and 15-8-120, MCA, as implementing citations for the rule, which is required by 2-4-305, MCA.

4. The department proposes to repeal the following rule:

<u>42.20.109 CAPITALIZATION RATES</u>

AUTH: 15-1-201, MCA
IMP: 15-7-111, MCA

REASONABLE NECESSITY: The department proposes to repeal ARM 42.20.109 because the most relevant content of this rule is proposed for transfer to ARM 42.20.108 for improved organization of the subject matter and description of the department's business processes. As additional information, (2) (regarding the band-of-investment method used to calculate the discount rate, a component of the yield capitalization rate) was not transferred to ARM 42.20.108 as the verbiage is unnecessary since there are multiple methods to calculate a yield capitalization rate.

5. Concerned persons may submit their data, views, or arguments, either orally or in writing, at the hearing. Written data, views, or arguments may also be submitted to: Todd Olson, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-7905; fax (406) 444-3696; or e-mail todd.olson@mt.gov and must be received no later than 5:00 p.m., July 8, 2024.

6. Todd Olson, Department of Revenue, Director's Office, has been designated to preside over and conduct the hearing.

7. The Department of Revenue maintains a list of interested persons who wish to receive notices of rulemaking actions proposed by this agency. Persons who wish to have their name added to the list shall make a written request, which includes the name and e-mail or mailing address of the person to receive notices and specifies that the person wishes to receive notice regarding particular subject matter or matters. Notices will be sent by e-mail unless a mailing preference is noted in the request. A written request may be mailed or delivered to the person in number 5 above or faxed to the office at (406) 444-3696, or may be made by completing a request form at any rules hearing held by the Department of Revenue.

8. An electronic copy of this notice is available on the department's web site at www.mtrevenue.gov, or through the Secretary of State's web site at sosmt.gov/ARM/register.

9. The bill sponsor contact requirements of 2-4-302, MCA, apply and have been fulfilled. The primary bill sponsor of Senate Bill 62 (2023), Senator Daniel Zolnikov, was contacted by email on May 9, 2024 and May 22, 2024.

10. With regard to the requirements of 2-4-111, MCA, the department has determined that the amendment and repeal of the above-referenced rules will not significantly and directly impact small businesses.

/s/ Todd Olson
Todd Olson
Rule Reviewer

/s/ Brendan Beatty
Brendan Beatty
Director of Revenue

Certified to the Secretary of State May 28, 2024.