



# The Florida Senate

*Interim Project Report 2006-126*

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Committee on Government Efficiency Appropriations

Senator Jeffrey H. "Jeff" Atwater, Chair

## **ASSESSMENT OF HOMESTEAD PROPERTY DAMAGED OR DESTROYED BY MISFORTUNE OR CALAMITY**

### **SUMMARY**

The Florida Constitution limits the growth in the assessed value of homestead property. When a new homestead is established it is assessed at just value, but growth in the assessed value is limited to the Consumer Price Index or 3 percent, whichever is lower. This assessment limitation, known as Save Our Homes, is implemented by s. 193.155, F.S. Subsection (4) of this section provides instructions for assessing changes, additions, or improvements to homestead property. It says that changes, additions, or improvements shall be assessed at just value as of January 1 after they are substantially completed, but makes an exception for replacement of real property damaged or destroyed by misfortune or calamity. When the just value of the replaced real property is no more than 125 percent of the value of the damaged or destroyed property, the replaced real property is not deemed to be a change, addition, or improvement.

In 2004, four hurricanes made landfall in Florida and caused widespread property damage. It is estimated that over 12,000 homesteads were destroyed by these storms, and over 28,000 suffered significant damage. The widespread damage and destruction of homestead property raised the general level of awareness of the law relating to assessment of such property, and possible shortcomings of that law. The Legislature enacted ch. 2005-268, Laws of Florida, which provides for a different treatment of homestead property that was damaged or destroyed by one or more of the named storms of 2004. This law provides that, for homestead property rendered uninhabitable by these storms, changes, additions, or improvements shall be assessed at just value only to the extent that square footage exceeds 110 percent of the homestead property's total square footage.

A survey was sent to each property appraiser in Florida, asking about his or her experience with assessing property that was damaged or destroyed by

misfortune or calamity. The survey results showed that the current statute does not adequately account for the effect of property appreciation in assessing replaced real property. It is possible that an identical replacement for damaged or destroyed property will exceed the 125 percent threshold and increase the assessed value of the property. The current statute also lacks clarity on the status of the homestead exemption on damaged or destroyed property while it is being repaired or replaced.

Based on the survey results and other suggestions from the property appraisers, and on input from Department of Revenue staff, this report recommends that s. 193.155, F.S., be amended to clarify the treatment of homestead property damaged or destroyed by misfortune or calamity. In particular, the statute should allow for replacement of such property without penalizing the property owner for the effect of rising property values.

### **BACKGROUND**

In 1992, Florida voters adopted an amendment to the Florida Constitution requiring homestead property to be assessed at just value as of January 1 of the year following the establishment of a new homestead, or after any change in ownership. Existing homesteads are assessed based on the prior year's assessment, adjusted by 3 percent or the Consumer Price Index, whichever is lower. This provision, found in Article VII, sec. 4 of the Florida Constitution and popularly known as Save Our Homes, had its initial impact on the January 1, 1995 tax rolls. Paragraph (5) of section 4. provides that changes, additions, reductions, and improvements to homestead property shall be assessed as provided for by general law, but subsequently, shall be assessed as provided by the Constitution. Paragraph (6) provides that if the property's homestead status is terminated, the property shall be assessed as provided by general law.

Section 193.155, F.S., implements the provisions of Save Our Homes. Subsection (4) provides instructions for assessing changes, additions, or improvements to homestead property. Generally, these are assessed at just value as of the first January 1 after they are substantially complete. The statute provides an exception to this policy for those cases where the property is being rebuilt due to misfortune or calamity. The relevant statutes read as follows:

(4)(a) Changes, additions, or improvements to homestead property shall be assessed at just value as of the first January 1 after the changes, additions, or improvements are substantially completed.

(b) Changes, additions, or improvements do not include replacement of a portion of real property damaged or destroyed by misfortune or calamity when the just value of the damaged or destroyed portion as replaced is not more than 125 percent of the just value of the damaged or destroyed portion. The value of any replaced real property, or portion thereof, which is in excess of 125 percent of the just value of the damaged or destroyed property shall be deemed to be a change, addition, or improvement. Replaced real property with a just value of less than 100 percent of the original property's just value shall be assessed pursuant to subsection (5).

(5) When property is destroyed or removed and not replaced, the assessed value of the parcel shall be reduced by the assessed value attributable to the destroyed or removed property.

In 2004, four hurricanes made landfall in Florida and caused widespread property damage. It is estimated that over 12,000 homesteads were destroyed by these storms, and over 28,000 suffered significant damage. The widespread damage and destruction of homestead property raised the general level of awareness of the law relating to assessment of such property, and possible shortcomings of that law. Because of these perceived shortcomings, the Legislature enacted CS/SB 1194 (Ch. 2005-268, LO.F.), which provides for a different treatment of homestead property that was damaged or destroyed by one or more of the named storms of 2004. This law provides that, for homestead property rendered uninhabitable by these storms, only that portion of changes, additions, or improvements

that exceeds 110 percent of the homestead property's total square footage shall be assessed at just value.

## METHODOLOGY

Senate staff reviewed s. 193.155, F.S., and discussed its potential problems with several property appraisers and Department of Revenue staff. Staff also surveyed the property appraisers concerning how they have implemented this statute in the past and what, if any problems, they have encountered. The property appraisers were also asked for suggestions about what, if any changes are needed to provide for equitable and efficient assessment of homestead property damaged or destroyed by misfortune or calamity. Twenty property appraisers responded to the survey, and they represented a mixture of small, medium, and large counties from around the state.

## FINDINGS

Review of s. 193.155, F.S., and discussion with Department of Revenue staff highlighted three questions that may not be clearly answered in the current law:

- What is the appropriate treatment of homestead property that is not repaired or replaced by January 1 following its damage or destruction?
- How should the property appraiser attribute value to property that is destroyed and not replaced?
- When property is replaced, how is the 125 percent cap calculated with respect to the date of assessment? This question is crucial when property values are appreciating rapidly, because the date at which the replacement property is assessed will affect its value, and whether it falls below the 125 percent cap. It would be possible for the new just value of a replacement structure that is identical to the one that was destroyed to exceed the cap if it is compared to the just value of the destroyed property at the time it was destroyed.

Appraisers were also asked whether the current statute has been the subject of taxpayer appeals and what the effect of ch. 2005-268, Laws of Florida, is anticipated to be. The property appraisers were invited to make suggestion about how the treatment of damaged or destroyed homestead property could be improved.

**Homestead property not repaired or replaced by the following January 1**

Section 193.155, F.S., implements the provisions of Save Our Homes by capping the annual increase in the assessed value of homestead property at 3 per cent or the CPI, whichever is less. It allows property that has been damaged or destroyed by misfortune or calamity to be repaired or replaced without affecting the assessment cap, but it does not provide any guidance about how the property should be assessed in any year following its damage or destruction when the repairs have not been substantially completed by January 1.

Section 192.042, F.S., requires that real property must be assessed on January 1 of each year, and provides that improvements or portions of improvements not substantially completed on January 1 shall have no value placed on them. "Substantially completed" means that the improvement or some self-sufficient unit within it can be used for the purpose for which it was constructed.

It is not clear how these statutory provisions work together. There is no guidance provided to the property appraisers as to whether improvements to homestead property that were damaged or destroyed by misfortune or calamity should be removed from the assessment roll, and whether the homestead exemption should remain in place for the property if it is not occupied on January 1.

In the survey sent to the property appraisers, two questions addressed this issue. The first asked:

*In valuing homestead property with improvements that have been damaged or destroyed by misfortune or calamity and not repaired or replaced by the following January 1st, does your office apply the provisions of s. 192.042(1), F.S., concerning improvements not substantially complete? Yes  No  Please explain:*

All appraisers indicated that destroyed property not substantially complete is given no value but the treatment of damaged property does not appear to be uniform. Several respondents indicated that the test for removing property from the tax roll is whether or not it is habitable, as indicated in the following responses:

*If damaged property cannot be used for its intended purpose on January 1 of a given tax year, we conclude that it is not substantially complete and do not place the value of a partially completed repair on the roll. The value*

*of the repaired property is added to the roll effective the first January 1 following the date that the repaired property can be used for its intended purpose.<sup>1</sup>*

*Property that is rendered uninhabitable by calamity is not assessed. This would be consistent with new construction that is not complete or habitable and therefore not assessed until it can be used for the intended purpose.<sup>2</sup>*

A few property appraisers' responses stated that they do not place any value on improvements unless the improvements were substantially complete, leaving open the question of whether a residence that is partly damaged but habitable would be assessed.

One property appraiser recommended that the Legislature consider amending s. 192.042, F.S., to make it apply specifically to new construction.<sup>3</sup> He gave an example of a building that requires extensive interior renovations due to some kind of damage but still has a market value substantially higher than the vacant land. The property may not be "substantially completed" but could have significant market value.

The survey asked whether property that is damaged or destroyed by misfortune or calamity and is uninhabitable on January 1 following the damage or destruction receives a homestead exemption. All of the responses indicated that the homestead exemption would be maintained under certain circumstances. The primary criterion cited by respondents for maintaining homestead exemption was the owner's intention to return to the property. Five property appraisers<sup>4</sup> indicated that property owners would be required to sign an affidavit or some other notification of intent to return to the property. Most respondents indicated that they require evidence that the property is being rebuilt or repaired, and that the property be reoccupied with a reasonable amount of time, either one or two years.

#### **Attribution of value to property that is destroyed and not replaced**

Paragraph (5) of s. 193.155, F.S., states that "When property is destroyed or removed and not replaced, the assessed value of the parcel shall be reduced by the

<sup>1</sup> Response of the Pinellas County Property Appraiser

<sup>2</sup> Response of the Seminole County Property Appraiser

<sup>3</sup> Flagler County Property Appraiser

<sup>4</sup> Orange, Brevard, Lee, Pinellas, and Seminole Counties

assessed value attributable to the destroyed or removed portion.” The statute provides no direction as to how a property appraiser should attribute value to the destroyed property. The survey asked the property appraisers to describe how they have determined the assessed value attributable to the destroyed or removed property, if they had experience with such situations.

All of the property appraisers described a method of attributing value whereby the percentage decrease in just value was applied to the assessed value, so that the damage was pro rated. This is consistent with the recommendations of the Department of Revenue in dealing with this situation.<sup>5</sup> This method requires the property appraiser to determine the reduction in just value, and various examples of how this is accomplished were provided. Some appraisers described using a square foot measure of the destroyed or removed area, while others measure the value of the destroyed or removed feature. Each of these methods appears to be appropriate for certain circumstances. The Pinellas County property appraiser describes using both methods, as follows:

*In our mass appraisal system, we remove the destroyed square footage of the damaged building from the building’s size calculations and drawing, or the damaged extra features from the property record, and calculate the cost approach to value on the undamaged property only. The difference between the building or extra feature before the damage occurred and the recalculated value with damaged portions removed is the value “attributable” to the destroyed or removed property.*

Several of the responses did not indicate specifically how the value of destroyed or removed property is determined; others reported that the mass appraisal system allows them to remove individual value components.

Under Save Our Homes, the assessed value of homestead property is determined, in part, by when it was put in place. If a homeowner builds an addition to his or her homestead, it will be assessed at its just value on January 1 after it is completed. All of the homestead property will not have the same Save Our Homes differential. The Brevard County property appraiser explains how this situation is handled in that county, as follows:

*Our system is programmed to annually track the changes to a property. If for example a property became a homestead in 1998, we capture the information related to the improvement as a permanent part of our assessment record, as well as all future rate changes for a market value and assessed value estimate. If a property lost an enclosed porch, we return to the qualifying year for the porch, remove the improvement, recalculate value and assessment cap forward to the current roll on the property, which reflects the capped value and market value of the remainder property without the lost improvement.*

**Calculation of the 125 percent threshold for determining whether replaced real property shall be deemed to be a change, addition, or improvement to be assessed at just value**

Section 193.155 (4)(b), F.S., allows for the repair or replacement of real property damaged or destroyed by misfortune or calamity. It says that if the value of the damaged or destroyed property as replaced is not more than 125 percent of the just value of the damaged or destroyed property, such replacement property is not considered a “change, addition, or improvement,” which would be assessed at just value.

If property values are stable, determining whether the replacement property exceeds this 125 percent threshold is a straightforward calculation for the property appraiser, based on the mass appraisal system. For the property owner, however, it is not so simple to determine whether a particular replacement will exceed the cap. The replacement’s cost does not necessarily equal its effect on the market value of the property, or its just value, as determined by the property appraiser. When the property owner is planning to replace damaged or destroyed property, he or she cannot know with certainty whether the threshold will be exceeded.

A further complication arises because of rising property values. The statute does not provide specific guidance, but in order to be fair to the property owner, the destroyed property and the replacement property should be valued as of the same date. For example, if a homestead with a just value of \$200,000 (excluding the value of the land) on January 1, 2004 was 50 percent destroyed by a hurricane in July 2004, the 125 percent threshold value for the replacement property, based on the January 1, 2004 assessed value, is \$125,000. If, however, real property is appreciating at 20% annually, the just value of *identical* replacement property would

<sup>5</sup> DOR presentation to PA’s (see appendix)

be \$144,000 on January 1, 2006, which exceeds the 125 percent statutory cap based on the just value of the destroyed property as of January 1, 2004. If the replacement property is valued as if it had been in place on the January 1, 2004, however, it will be under the cap and will not change the value of the homestead for Save Our Homes purposes.

Rule 12D-8.0063, F.A.C., provides instructions for assessing changes, additions, or improvements to a homestead. Subsection (4) gives an example of how the 125 percent threshold is to be calculated, but it does not provide guidance on how to account for the impact of property appreciation. Subsection (5) says that if the damaged portion is not replaced in the year the damage occurred, but is replaced in a subsequent year, the replacement will be treated as a change, addition or improvement as provided in subsections (3) and (4), *adjusted for changes in market and homestead property assessment limitation values*, but no further explanation is given.

In the survey, the property appraisers were asked on what date they valued property that was destroyed by misfortune or calamity and property that replaced the damaged or destroyed property, for purposes of determining the 125 percent cap. Only three responses indicated clearly that a common baseline was used to calculate the value of the replacement property. These property appraisers assess the replacement property as if it had been in place on January 1 of the year in which the destruction occurred. Six property appraisers said that they used the values before and after the damage occurred, which results in the situation described above, where identical rebuilt property could exceed the cap. The rest of the responses said that the value of the damaged or destroyed property was based on the January 1 following the damage, and the value of the replacement property was based on the January 1 after it was completed. This method will provide a common baseline and remove the effect of rising property values only if the repairs are completed within the same year that the damage occurred.

### **Appeals to the Value Adjustment Board**

Of the 20 responses received, only one reported that an assessment of damaged or destroyed property had ever been appealed to the Value Adjustment Board. One property owner in Alachua County appealed the property appraiser's application of the 125 percent threshold, but the appraiser's approach was upheld by the VAB.

### **Will hurricane-damaged properties exceed the square footage cap, and would they have exceeded the 125 percent value cap?**

The fiscal impact of SB 1194, which became ch. 2005-268, Laws of Florida, was determined by the Revenue Impact Conference to be a recurring local revenue loss of \$13.1 million. In an attempt to verify this figure, the property appraisers were asked to estimate the percentage of hurricane-damaged properties that will fall below the 110 percent square footage cap enacted for such property in 2005. They were also asked to estimate how many would have been below the 125 percent value threshold. Several of the respondents reported that they could not provide estimates, since most properties were not replaced or repaired before January 1, 2005. Charlotte County reported that most damaged or destroyed homestead properties appear to be remaining under the square footage cap, but that a large majority would have exceeded the 125 percent value threshold. Marion County estimates that about 90 percent of damaged or destroyed properties will fall under the square footage cap, but only 70 percent would fall below the value cap. Orange County reports that most repairs and replacements would be below either threshold. Brevard County reports that 95 percent of rebuilt properties will fall within the 110 percent threshold.

### **Suggestions for changes in the treatment of damaged or destroyed property to increase fairness and ease of administration**

The property appraisers' responses to this request were dominated by two suggestions: a call for consistency in the treatment of all homestead property damaged or destroyed by misfortune or calamity, and a request to permanently implement the physical standard provided for 2004 storm damage. The Pinellas County property appraiser made this suggestion for consistent treatment:

*The Legislature should not develop a new tax relief statute or replacement property statute specific to a single year or specific disaster. If it is good public policy to give property owners a break when their homes are destroyed by a disaster, then the Legislature should enact a statute that can be applied in any year or for any degree of disaster. A single homeowner who loses his or her home because of a fire caused by lightning in a small thunder storm should be given the same consideration as homeowners who lose their property in a massive "hurricane like" disaster. This policy should include procedures for filing deadlines,*

*notifications, and appeals, mirroring those already established for VAB filings. In addition, penalties for fraudulent applications for relief should be established.*

The Osceola County property appraiser argues for the physical standard by saying:

*I believe that we need to go with the system that helps the greater number of taxpayers. The 110% seems to be the best way to help the most people. If a person was forced to rebuild or remodel a house because of unforeseen destruction, why should they have to pay more taxes if all that they are doing is replacing the house that they lost? I do believe that if they build a larger home, then they should pay the additional taxes.*

Another suggestion came from the Flagler County property appraiser. He suggested that s. 192.042, F.S., the statute that says that improvements or portions of improvements not substantially completed on January 1 shall have no value placed on them, should be amended to apply specifically to new construction. He points out, as an example, that a large commercial rental building that requires extensive interior renovations due to some form of damage could still have a market value substantially higher than if the property were vacant. It is possible that a property valued as vacant land on the tax roll could sell for several times the value of the vacant parcel.

o Alternately, the Legislature could adopt a physical threshold, such as the 110 percent of square footage threshold in ch. 2005-268, Laws of Florida;

- Whether the cap is based on value or some physical measurement, the same standard should apply to all homesteads damaged or destroyed by misfortune or calamity.

## RECOMMENDATIONS

Based on the problems and ambiguities in the taxation of homestead property damaged or destroyed by misfortune or calamity that came to light after the 2004 hurricane experience, and the recommendations and comments offered by the property appraisers, some changes in the relevant statutes deserve consideration by the Legislature.

- The statute should be amended to specify how homestead property should be treated if it is not repaired or replaced by January 1 following damage or destruction;
- The treatment of repaired or replacement property should be amended one of two ways:
  - o If the 125 percent just value threshold is maintained, the statute should provide that it will be assessed as of the same date as the property it is being compared to for the purpose of measuring the increase in value;