

Issue Paper Number **08-004**



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

BIOPHARMACEUTICAL INDUSTRY- BUSINESS PROPERTY ASSESSMENT PRACTICE GUIDELINES

I. Issue

Should the Board update the current valuation factors for Biopharmaceutical Industry Equipment and Fixtures.

II. Alternative 1 - Staff Recommendation

Staff recommends that the Board update the valuation factors to add a trending index.

III. Other Alternative(s) Considered

None

IV. Background

The State Board of Equalization (Board) co-administers the property tax in California with the county assessors. The 58 county assessors are charged with the assessment of locally assessed real and personal property for taxation purposes and resolution of appeals of property values at local levels in conjunction with county assessment appeals boards. The Board's role is advisory and does not include setting values for any locally assessed property or for resolving disputes over those assessments.

Section 401.5 of the Revenue and Taxation Code requires that the Board shall issue to assessors data relating to costs of property and other information to promote uniformity in appraisal practices and in assessed values throughout the state. In an effort to comply with section 401.5, the Board publishes Assessors' Handbook Section 581, *Equipment Index and Percent Good Factors* (AH 581), on an annual basis. Among other data, AH 581 contains tables of valuation factors for non-production computer equipment, semiconductor manufacturing equipment, and biopharmaceutical industry equipment and fixtures.

The equipment index factors published in AH 581 are generally reliable for converting a property's original cost to an estimate of Reproduction Cost New (RCN). Percent good factors, which are the compliment of depreciation factors, are then applied to the RCN to arrive at an estimate of market value. The valuation factors are applied directly to the original cost of a property to arrive at an estimate of market value.

Industry representatives expressed interest for the Board to review current data to validate or update the information contained in AH 581 relative to the valuation of biopharmaceutical equipment and fixtures, non-production computer equipment, and semiconductor manufacturing equipment. Conducting studies based on current data will result in the ability to calculate more reliable and accurate assessed values. As a result, there may be fewer disputes between county assessors and taxpayers over values and a resultant decrease in assessment appeals filed, thereby realizing a cost avoidance for both private industry and local government.

V. Discussion

Budget Change Proposal 6 (BCP 6), approved in 2006, provided two positions on a two-year limited term basis for Fiscal Year (FY) 2006-07 and FY 2007-08 to create, and participate on, teams to conduct studies in the development of valuation factors for biopharmaceutical equipment and fixtures, non-production computer equipment, and semiconductor manufacturing equipment. Each team consists of a Principal Property Appraiser and Senior Specialist Property Auditor Appraiser from the Board, two industry representatives and two representatives from the California Assessors' Association.

The biopharmaceutical industry valuation factors were last updated in October 1999. The Board adopted valuation factors were based on input from various interested parties meetings and on an analysis of information provided by industry. The Board issued Letter To Assessors (LTA) 99/54, *Interim Guidelines for the Valuation of Biopharmaceutical Industry Equipment and Fixtures*, on October 8, 1999, that defined what categories of firms made up the "Biopharmaceutical Industry," and provided that the valuation factors were to be applied directly to the reported historic costs. In addition, LTA 99/54: (1) provided a sample listing of the common types of equipment found in this industry, (2) specified the equipment categories on the business property statement to report the common types of equipment, and (3) provided the valuation factors to be used for each category of equipment.

FORMAL ISSUE PAPER

The California Assessors' Association (CAA) published position paper 99-004 addressing the information disseminated in LTA 99/54. In the position paper, the CAA states, in part, that:

However, the California Assessors' Association strongly disagrees with the valuation factor tables specified in LTA 99/54 since they are predicated upon using untrended historical costs in calculating market value. It is the California Assessors' Association position that use of the SBE factors found in LTA 99/54 is contrary to correct appraisal procedure and would create an inequity in assessment values for like property not defined as being in the biopharmaceutical industry ... the California Assessors' Association adopts the following recommendations, which were presented in SBE FORMAL ISSUE PAPER No. 99-042 but not adopted by the elected SBE board members.

It was anticipated that when the study began market data would be readily available. When the biopharmaceutical team first met, it was requested that any market data that was available be forwarded to the Board staff members. In addition, Board staff members would pursue acquisition of market data independently.

Staff spent over a year pursuing market data. Additionally, staff reviewed the books and records of the two largest biopharmaceutical companies in California to determine if a lifing study could be performed. It was determined that the retirement records of the biopharmaceutical companies were not sufficiently up to date and therefore could not be used to perform such a study.

On January 31, 2008, the County-Assessed Properties Division presented a status report on the progress of the biopharmaceutical study to the Board's Property Tax Committee. Specifically, the Board was informed that there is no current market data available on which to base a study. Additionally, the Board was informed that there was insufficient data to conduct a lifing study. The Board directed staff to return to the Board in May and present interested parties' recommended factors to the Committee for a decision.

As was the case in 1999, staff was unable to gather the evidence necessary to empirically calculate average service lives for biopharmaceutical business property. Nor was any current market data available. Ultimately, the use of appraisal judgment was required to make this recommendation.

Because current market data is not available, staff reviewed the study of Biopharmaceutical Properties that was submitted to the Board in 1999 by the Ventura County Assessor. Board staff used this study as the basis for the staff recommendation in Issue Paper 99-042, which was presented to the Board in August 1999. On October 7, 1999, the Board adopted the lives recommended in the Ventura County study, but the Board, however, declined to add a trending index as suggested by the report.

A meeting was held by Biopharmaceutical Valuation Factor team and it was agreed that a trending index should be applied to the factors currently published in the AH 581 for Biopharmaceutical Equipment and Fixtures, which are based on the Ventura County study. There was a general consensus among the team to apply index factor trending to the current valuation factors in the AH 581.

VI. Alternative 1 - Staff Recommendation

Staff recommends that the valuation factors for Biopharmaceutical Industry Equipment and Fixtures be updated in the AH 581 to include application of index factors from Table 2: *Industrial Machinery and Equipment Index Factors* to add a trending index to the current valuation factors (See Attachment A).

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A. Pros of Alternative 1

Application of index factors from Table 2: *Industrial Machinery and Equipment Index Factors*, to add a trending index to the current valuation factors is consistent with what was recommended to the Board by Amgen, Inc., Ventura County, and Board staff in 1999 and is currently recommended to the Board by the Biopharmaceutical Valuation Factor Team.

B. Cons of Alternative 1

None

C. Statutory or Regulatory Change for Alternative 1

None

E. Operational Impact of Alternative 1

None

F. Administrative Impact of Alternative 1

1. Cost Impact

None

2. Revenue Impact

It is anticipated that there would be very little revenue impact since the recommendation is what the California Assessors' Association currently recommends.

G. Taxpayer/Customer Impact of Alternative 1

None

H. Critical Time Frames of Alternative 1

None

Preparer/Reviewer Information

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Current as of: May 7, 2008

Reporting Categories and Average Service Lives

BIOPHARMACEUTICAL INDUSTRY- BUSINESS PROPERTY ASSESSMENT PRACTICE GUIDELINES

| REPORTING CATEGORIES | TRENDING/INDEX FACTORS* | AVERAGE SERVICE LIVES | MINIMUM PERCENT GOOD |
|-------------------------------------|-------------------------|-----------------------|----------------------|
| Lab Equipment | Table 2 ¹ | 6 Years | 10% |
| Commercial Manufacturing Equipment | Table 2 ¹ | 10 Years | 10% |
| Pilot Scale Manufacturing Equipment | Table 2 ¹ | 8 Years | 10% |
| Fixtures and Process Piping | Table 2 ¹ | 10 Years | 10% |

***Board Staff Recommends Trending for all Biopharmaceutical Property**

**SEE ATTACHMENT B FOR AN ILLUSTRATION OF THE ABOVE
RECOMMENDED GUIDELINES.**

¹ Table 2, *Industrial Machinery and Equipment Index Factors*, from AH 581.

Example of Computation of Valuation Factors for Biopharmaceutical Industry Equipment and Fixtures and Application of the Factors

The following examples use index factors and the interim valuation factors for Biopharmaceutical Industry from the January 2008 Assessors' Handbook Section 581 (AH 581), *Equipment Index and Percent Good Factors*, to illustrate how (1) the Biopharmaceutical Industry Equipment and Fixtures Valuation Factors will be computed each year, and (2) how the valuation factors will be applied in the computation of the assessed value of the property.

As indicated in Attachment A, there are four different reporting categories for the Biopharmaceutical Industry. The following provides examples in the computation and application of the Biopharmaceutical Commercial Manufacturing Equipment valuation factors using Board staff's recommendation that the Board update the valuation factors to add a trending index. Please note that the valuation factors will be updated each year to reflect application of current trending index factors.

Example 1: Sample of the Computation of the Valuation Factor Table for Property Tax Assessment of Biopharmaceutical Industry Commercial Manufacturing Equipment using Tables from the 2008 revision of AH 581.

Biopharmaceutical Industry Machinery and Equipment Computation of Valuation Factor

| Year Acquired | Age | Machinery & Equipment | | |
|------------------|-----|-------------------------------|------------------------------|----------------------------------|
| | | Index Factors ² | Percent Good ³ | Valuation Factor ⁴ |
| | | (A) | (B) | (A x B) |
| 2007 | 1 | 1.00 | .85 | .85 |
| 2006 | 2 | 1.03 | .69 | .71 |
| 2005 | 3 | 1.05 | .54 | .57 |
| 2004 | 4 | 1.10 | .40 | .44 |
| 2003 | 5 | 1.13 | .28 | .32 |
| 2002 | 6 | 1.14 | .18 | .21 |
| 2001 | 7 | 1.14 | .11 | .13 |
| 2000 | 8 | 1.14 | .10 | .11 |
| 1999 | 9 | 1.15 | .10 | .12 |
| 1998 | 10 | 1.16 | .10 | .12 |
| 1997 | 11 | 1.18 | .10 | .12 |
| 1996 | 12 | 1.19 | .10 | .12 |

² For illustration purposes only, factors are from Table 2 of the 2008 revision of AH 581.

³ For illustration purposes only, factors are from Table 9 (A-1) of the 2008 revision of AH 581.

⁴ Valuation factors will be updated on an annual basis and published in the annual revision of AH 581.

Example 2: Sample of the application of the Biopharmaceutical Industry Commercial Manufacturing Equipment Valuation Factors using the sample table in Example 1.

Because the valuation factors include the effect of price changes (index or trend) and depreciation, the assessed value is computed by applying the valuation factor to the acquisition cost of the biopharmaceutical manufacturing equipment. The following illustrates the computation of the assessed value of biopharmaceutical manufacturing equipment acquired in 2005 with an acquisition cost of \$250,000.

| Equipment Group | Year of Acquisition | Cost | Valuation Factor | Replacement Cost Less Normal Depreciation |
|-------------------------|----------------------------|-------------|-------------------------|--|
| Manufacturing Equipment | 2005 | \$250,000 | .57 | \$142,500 |

In the above example, the replacement cost new less normal depreciation of biopharmaceutical manufacturing equipment purchased in 2005 for \$250,000 is \$142,500 on lien date January 1, 2008.

NOTE: *The tables provided in the above example use the tables from the 2008 revision of AH 581 and are for illustration purposes only.*