

CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Petition for
 Reassessment of the 2018 Unitary Value for:)
)
)
WILD GOOSE STORAGE, LLC)
(195))
 Petitioner)

Appeal No.: SAU 18-023

Case ID No.: 1056753

Nonappearance Hearing Date:
 November 8, 2018¹

Representing the Parties:

For the Petitioner:

Antreas E. Ghazarossian, President
 Cost Containment Advisors, Inc.

For the Respondent:

Richard Moon, Tax Counsel IV
 Attorney for the State-Assessed Properties Division

Samuel Wang, Principal Property Appraiser
 State-Assessed Properties Division

Appeals Attorney:

Susan Galbraith, Tax Counsel

VALUES AT ISSUE

	Value	Penalty	Total
2018 Board-adopted Unitary Value	\$178,900,000	\$0	\$178,900,000
Petitioner's Requested Unitary Value	\$111,900,000	\$0	\$111,900,000
Respondent's Appeal Recommendation	\$171,400,000	\$0	\$171,400,000
Respondent's Revised Recommendation	\$159,100,000	\$0	\$159,100,000

Factual Background

Wild Goose Storage, LLC (petitioner), a subsidiary of Niska Gas Storage Partners, LLC (Niska), owns and operates a natural gas storage facility in Butte County in northern California. Niska acquired

¹ The Board voted unanimously to grant the petition for reassessment, in part, and reduce the 2018 Board-adopted unitary value to \$899,300,000.

1 petitioner in July 2016. After the purchase, a purchase price allocation (PPA) allocated \$291 million of
2 the purchase price to petitioner's fixed asset accounts. (SAPD's Analysis for Appeals Attorney, p.1;
3 Petition, p. 1.) The 2018 Board-adopted unitary value of petitioner's facility is based on 50 percent
4 reliance on the Reproduction Cost Less Depreciation (ReproCLD) value indicator and 50 percent
5 reliance on the Capitalized Earning Ability (CEA) value indicator. As noted, the petitioner raised three
6 issues in its petition and respondent and petitioner are in agreement as to Issue 1 and Issue 2, and are not
7 in agreement as to Issue 3.

8 **Issue 1** addresses whether respondent should allow additional capital expenditures (CapEx) for
9 equipment replacements in the calculation of the CEA value indicator. Respondent states that it based its
10 CapEx allowance of \$600,000 on petitioner's own forecast created in 2016 when the gas storage facility
11 was purchased, that petitioner provided no life study or financial documentation to support its \$9.5
12 million projected annual CapEx, that petitioner did not provide sufficient documentation that additional
13 capital replacements are required to meet new regulations due to the Aliso Canyon gas leak, and
14 respondent believed a significant portion of petitioner's fixed assets would already have been retired and
15 replaced since petitioner's facility has been in operation for 15 years. In fact, petitioner has not retired
16 many of its fixed assets. After filing its original SAPD analysis, respondent reviewed the new
17 information from petitioner and determined that the \$600,000 allowance was regular maintenance and
18 repair costs. Respondent thereafter estimated the appropriate CapEx for petitioner's CEA calculation to
19 be \$4.6 million annually. Petitioner is in agreement with respondent's revised CapEx for the CEA
20 calculation.

21 **Issue 2** addresses whether respondent should allow a business inventory adjustment in the
22 calculation of the CEA indicator. Petitioner claims that an allowance for business inventory should be
23 made for natural gas that is purchased, stored, and sold for the purpose of utilizing storage capacity,
24 injection, and withdrawal capacity. Since business inventories are exempt from taxation under section
25 129 of the Revenue and Taxation Code, the *Unitary Value Methods* (March 2003) handbook allows a
26 deduction from net income of the average inventory amount. Based on information provided during the
27 appraisal and in the petition, respondent reduced the CEA value indicator to reflect the average business
28 inventory exemption allowance, and petitioner is in agreement with this reduction. After the reduction

1 recommended for both Issue 1 and Issue 2, the CEA value indicator is \$115,582, 643, a reduction of
2 \$39,567,142.

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4 **Legal Issue: Whether petitioner has shown that respondent failed to place proper reliance on the**
5 **CEA value indicator for lien date 2018.**

6 **Findings of Fact and Related Contentions**

7 Petitioner contends that respondent has not placed proper reliance on the cost and income value
8 indicators for lien date 2018, and, as a result, the Board has overstated the value of petitioner's property.
9 Petitioner asserts that respondent's 50 percent reliance on the cost indicator and 50 percent reliance on
10 the CEA value indicator is not appropriate. Petitioner states that "in an open market, any willing buyer
11 will base their decision on the earnings ability of a potential investment to make a decision to invest.
12 With this in mind, it is our opinion that a majority of the weight should be placed on the earnings
13 capability." (Petition, p. 5.) Accordingly, petitioner requests a 75 percent reliance on the CEA value
14 indicator and a 25 percent reliance on the cost indicator, resulting in an additional reduction of
15 \$47,200,000 from respondent's revised recommended value resulting in petitioner's requested value of
16 \$111,900,000.

17 Respondent contends that 50 percent reliance, and not 75 percent reliance, on the CEA value
18 indicator is appropriate for petitioner's unitary property as of lien date 2018. Respondent cites Property
19 Tax Rule² 6, which provides that when a facility is new, the cost indicator is normally a more reliable
20 value indicator and should generally be given greater reliance. Rule 8, subdivision (a), provides that the
21 income approach to value is used in conjunction with other approaches when the property under
22 appraisal "has an established income stream or can be attributed a real or hypothetical income stream by
23 comparison with other properties." Respondent also refers to Assessors' Handbook section 502,
24 *Advanced Appraisal* (AH 502) (Dec. 1998, reprinted Jan. 2015), which discusses the criteria an
25 appraiser should consider when reconciling value indicators, including the appropriateness of the value
26 indicator, the accuracy of the data and adjustments, and the quantity of evidence available for each value
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28 _____
² All references to Property Tax Rules or Rule are to sections of title 18 of the California Code of Regulations.

1 indicator. Respondent asserts that greater reliance is placed on the cost approach when the property is
2 new, and on the CEA value indicator once the facility has established a sufficient positive earnings
3 history, or earnings that can be reasonably and accurately forecasted. (SAPD's Revised Analysis for
4 Appeals Attorney, p. 4.)

5 Respondent considered the cost approach to be reliable since petitioner's acquisition and PPA
6 were completed less than two years ago and the purchase price was allocated to the fixed asset accounts
7 according to their fair market value at that time. Respondent also allowed a 24.5 percent economic
8 obsolescence adjustment based on an income shortfall method by comparing petitioner's expected
9 income at the time of the acquisition and the current expected income, which is consistent with Board-
10 published *Guidelines for Substantiating Additional Obsolescence for State-Assessed Telecommunication*
11 *Properties*.³

12 Additionally, respondent considered that the gas storage industry in general has suffered
13 financially due to the stabilized price in the natural gas market. (SAPD's Revised Analysis for Appeals
14 Attorney, p. 4.) Petitioner also recognizes that recent growth in shale gas production has resulted in
15 lower gas prices and reduced price volatility, and that the increased availability of natural gas supplies
16 reduced the reliance on natural gas storage facilities as a supply source in winter. (Petition, p. 2.)
17 Respondent states that, in order to capture all forms of obsolescence, respondent placed 50 percent
18 reliance on the cost value indicator and 50 percent on the CEA value indicator since petitioner had two
19 years of positive and consistent earning history. However, respondent asserts that since the current
20 owner has owned the facility for less than two years, coupled with the relatively high degree of
21 uncertainties in the gas storage industry, placing additional reliance on the CEA value indicator is
22 inappropriate.

23 Finally, respondent states that petitioner has not provided documentation to support its request
24 for 75 percent reliance on the CEA value indicator and 25 percent reliance on the cost value indicator,
25 and therefore respondent recommends that no adjustment be made for Issue 3.
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³ https://www.boe.ca.gov/proptaxes/pdf/Obsolescence_Guidelines.pdf

Applicable Law and Appraisal Principles

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, Petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5541, subd. (a).)

Reconciliation of Value Indicators

Property Tax Rule 3 requires that, in estimating value, the assessor shall consider one or more of the approaches to value “as may be appropriate for the property being appraised,” which includes the comparative sales approach, the replacement or reproduction cost approach (e.g., ReplCLD valuation methodology), or the income approach. The appropriateness of an approach is often related to the type of property being appraised and the available data. (Assessors’ Handbook section 502, *Advanced Appraisal* (December 1998) (AH 502), p. 109.) In addition, the validity of a value indicator will depend upon the accuracy of data and adjustments made to the approach. That is, the accuracy of a value indicator depends on the amount of available comparable data, the number and type of adjustments, and the dollar amount of adjustments. Finally, if a large amount of comparable data is available for a given approach, the appraiser may have more confidence in that approach. For example, if income, expense, and capitalization rate data can be obtained from many properties comparable to the subject, the appraiser may attribute significant accuracy to the income approach. The greatest reliance should be placed on that approach or combination of approaches that best measures the type of benefits the subject property yields. The final value estimate reflects the relative weight that the appraiser assigned, either implicitly or explicitly, to each approach. (AH 502, p. 112.)

Income Approach to Value

Property Tax Rule 8, subdivision (a), states that “the income approach is used in conjunction with other approaches when the property under appraisal is typically purchased in anticipation of a money income and either has an established income stream or can be attributed a real or hypothetical income stream by comparison with other properties.” Subdivision (b) describes the income approach to value as the valuation method whereby, “an appraiser values an income property by computing the

1 present worth of a future income stream. This present worth depends upon the size, shape, and duration
2 of the estimated stream and upon the capitalization rate at which future income is discounted to its
3 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a
4 reasonably well-informed owner and reasonably well informed buyers may anticipate on the valuation
5 date that the taxable property existing on that date will yield under prudent management and subject to
6 legally enforceable restrictions as such persons may foresee as of that date.”

7 **The Reproduction Cost Approach to Value**

8 Property Tax Rule 6, subdivision (a) provides, in part, that: “The reproduction or replacement
9 cost approach to value . . . is preferred when neither reliable sales data . . . nor reliable income data are
10 available . . .” In general, the “reproduction cost of a reproducible property may be estimated either by
11 (1) adjusting the property’s original cost for price level changes and for abnormalities, if any, or (2)
12 applying current prices to the property’s labor and material components, with appropriate additions for
13 entrepreneurial services, interest on borrowed or owner-supplied funds, and other costs typically
14 incurred in bringing the property to a finished state.” (Property Tax Rule 6, subd. (b).) The resulting
15 adjusted cost is the reproduction cost new (ReproCN) which is then “reduced by the amount that such
16 cost is estimated to exceed the current value of the reproducible property by reason of physical
17 deterioration, misplacement, over or under improvement, and other forms of depreciation or
18 obsolescence.” (Property Tax Rule 6, subd. (e).)

19 ReproCN is an estimate of the current cost to replace the existing property with a new property
20 that is an exact replica, or virtually so, of the existing property. Data for the derivation of the ReproCN
21 index factors can be obtained either from prices quoted by current vendors of the property or by
22 applying an appropriate index factor to the historical or original acquisition cost of the property. The
23 use of published index factors is the preferred method when performing mass appraisals. Numerous
24 trade publications provide index factors for the conversion of historical cost to ReproCN. The
25 publishers of these index factors generally survey industry participants and equipment manufacturers
26 and compare current prices to a historical cost database. The ratio of price change for a given annual
27 period is the ReproCN index factor.

28 The calculation of the ReproCLD indicator is basically a two-step process. First, the

1 reproduction cost new (ReproCN) is calculated by applying an index factor (also known as “trend
2 factors”) to the historical acquisition cost of property, segregated by year of acquisition. Second, the
3 ReproCN is adjusted for normal depreciation by the application of a percent good factor to the
4 ReproCN. The product of this calculation is the ReproCLD value indicator. (*Unitary Valuation*
5 *Methods* (March 2003), p. 11.)

6 For the ReproCLD indicator, depreciation is the difference in value between a new identical
7 substitute property and the existing property. The difference is recognized as the complement to the
8 percent good factors. Respondent conducts service life studies to assist in determining the appropriate
9 percent good factors. The usefulness of the ReproCLD in the appraisal process depends on whether or
10 not the market recognizes an exact replica of the subject property as having adequate utility for the
11 operational needs of an ongoing business. If there are economical substitutes (i.e., a property of lower
12 cost or greater utility for the property being appraised), the ReproCLD indicator may not be a reliable
13 method to determine the fair market value of a subject property.

14 **Analysis and Disposition**

15 Respondent is presumed to have correctly determined the value of the property at issue, and
16 petitioner bears the burden of proving otherwise. Here, the parties agree on the use of the ReproCLD
17 and CEA value indicators to value the unitary property, but differ over the appropriate amount of
18 reliance placed on each value indicator.

19 Petitioner contends that respondent should place a greater reliance on the CEA value indicator.
20 Petitioner states that in an open market, any willing buyer will base their decision on the earnings
21 ability of a potential investment, and therefore petitioner believes that a majority of the weight should
22 be placed on the earnings capability. However, petitioner provides no documentation in support of its
23 request that 75 percent reliance be placed on the CEA value indicator.

24 Property Tax Rule 8 provides that reliance on the income approach is appropriate when the
25 property has an “established income stream or can be attributed a real or hypothetical income stream by
26 comparison with other properties.”

27 In the view of the Appeals Attorney, the factors and circumstances that affect gas storage prices,
28 as described by petitioner, indicate a high degree of unpredictability in the level of future income.

Hence, the Appeals Attorney finds that petitioner has not shown evidence of a sufficiently established income stream for the respondent to justify weighting the CEA value indicator 75 percent and the cost indicator 25 percent, and has not presented evidence to show that the property may be attributed a real or hypothetical income stream by comparison with other properties. Accordingly, the Appeals Attorney concludes that petitioner has failed to meet its burden of proving that respondent's determination to place 50 percent reliance on the cost indicator and 50 percent reliance on the CEA value indicator was in error.

Decision

Accordingly, the petition for reassessment is denied, in part, and granted, in part, as to Issue 1 and Issue 2, reducing the 2018 Board-adopted unitary value to 159,100,000.*

George Runner _____, Chairman

Diane L. Harkey _____, Member

Jerome Horton _____, Member

* The decision was rendered in Sacramento, California on November 8, 2018. This summary decision document was approved on February 26, 2019, in Sacramento, California.

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