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Assessment of Billboard Properties

Description of Billboards

Billboards, or off-premise outdoor advertising signs, make advertising space available to advertisers for display to the public. These signs do not advertise the business or other activity occurring at the site on which the billboard is located. The larger and most common types of billboards are usually located on leased property adjacent to freeways, highways and other major thoroughfares.

Almost all billboards are owned by billboard companies. Billboard companies offer display space on their billboards to advertisers for a fee. The billboard companies also place and remove the advertisements and may design and produce the advertising copy, although this function is usually performed by the advertiser's advertising agency.

Advertising space is often marketed for a group of billboards rather than for a single billboard. These group sales are called "showings." Billboard companies know approximately how many people see each of their billboards each day and their demographic attributes. Using this information, the companies are able to configure their billboard inventories into showings that provide a specified level of advertising exposure for various advertisers' target markets.

Classification of Billboards

Billboards are properly classified as fixtures under Property Tax Rule 122.5(a)(1), which defines a fixture to include an item of tangible property which is "physically or constructively annexed to realty with the intent that it remain annexed indefinitely." In general, billboards are affixed to the ground, are moved infrequently, and are intended to remain annexed indefinitely. These circumstances require that billboards be classified as fixtures.

Billboard Property Components and Appraisal Unit

The appraisal unit refers to the nature and extent of the property being valued. For property tax purposes, unless the law specifically provides otherwise, the appraisal unit is the unit of property commonly bought and sold. [1]

The sale of a billboard property normally includes the following: (1) the *billboard improvement* (i.e., the sign and its foundation), (2) the *billboard use permit (or permits),* which allows the billboard owner to construct and operate the billboard; and (3) the *leasehold interest* in the land, or billboard site. These three elements constitute the billboard appraisal unit, designated here as the *billboard property*. The ground lessor's interest in the billboard site (i.e., the interest held by the fee owner of the billboard site) is a separate appraisal unit.

[1] See Revenue and Taxation Code section 51(e); Property Tax Rule 324; and AH 502, (December 1998), pp. 2-5.

Approaches to Value

Any of the three generally accepted approaches to value can be used to value a billboard property or a group of billboard properties.[2] Discussed briefly below are the cost approach, the comparative sales approach (using an effective gross income multiplier, or "EGIM"); and the income approach, using direct capitalization with a sales-derived overall capitalization rate.[3]

Cost Approach

Applying the cost approach to a billboard property involves the following steps:

1. Estimate the cost new of constructing and siting the billboard improvement.
2. Estimate the depreciation incurred by the billboard improvement.[4]
3. Subtract the estimated depreciation from the cost new to arrive at the depreciated cost of the billboard improvement.
4. Estimate the value of the leasehold interest in the billboard site held by the billboard company.
5. Add the value of the leasehold interest in the billboard site to the cost new less depreciation of the billboard improvement to arrive at a value indicator for the billboard property.

The estimated cost new should reflect the full economic cost of creating the substitute billboard improvement, comprising direct ("hard") costs, indirect ("soft") costs, and entrepreneurial profit.[5] Cost data may be obtained from property statements filed by billboard companies or from contractors who construct billboard improvements. At present, there is no authoritative, published source of current cost data for billboard improvements.

In most applications of the cost approach, the depreciated cost new of the improvements is added to the estimated value of the fee simple interest in the land. With a billboard property, however, only the leasehold interest in the billboard site (the interest in land held by the billboard company)

[2] For additional information concerning the approaches to value generally, see AH 501, AH 502, or a general appraisal text.

[3] Assessors may rely upon the same authorities for gathering relevant assessment data about billboard properties as is relied upon on for other types of property. Such authorities include the general requirement, under section 441 of the Revenue and Taxation Code, that persons make available to the assessor information or records regarding his or her property.

With respect to billboard properties, the assessor may request a timely filed property statement (Form 571L) showing all taxable billboard property, including its location and description, that is owned, claimed, possessed, controlled, or managed by the company.

[4] As other improvements, billboards are subject to three forms of depreciation, or loss in value: physical deterioration, functional obsolescence, and external obsolescence. In typical practice, the depreciation of a billboard improvement is estimated using age-life depreciation, or percent-good, tables. AH 581 contains tables of index and percent good factors for various types of fixtures. Used in conjunction, these two types of factors produce an estimate of cost new less depreciation.

[5] Revenue and Taxation Code section 401.6 requires market-derived evidence of entrepreneurial profit when the cost approach is used to value special use property.

is included in the appraisal unit, not the full fee simple interest. Thus, when applying the cost approach to a billboard property, only the estimated value of the leasehold interest in the billboard site should be added to the depreciated cost new of the billboard improvement. One method of estimating this value is to extract it from the sale price of a comparable billboard property.

In all approaches, the value of intangible assets and rights must be excluded from the final value indicator for the taxable property. In general, this adjustment is simpler in the cost approach than other approaches because, in the cost approach, intangible assets and rights typically are not included as components of cost new.

COMPARATIVE SALES APPROACH—EFFECTIVE GROSS INCOME MULTIPLIER

In direct sales comparison, a value indicator is developed by comparing a comparable property to the subject property and adjusting the sale price of the comparable property for differences between it and the subject.[6] Billboard properties, however, typically sell in groups, and there is little data regarding sales of individual billboard properties. This makes it difficult to apply direct sales comparison to billboard properties.

Since sales of individual billboard properties rarely occur, it is usually more practicable to use an effective gross income multiplier (EGIM) derived from a sale of a group of billboard properties. The EGIM method is commonly used within the billboard industry as a method of valuation for billboard properties.

To derive an EGIM, the sale price of a comparable billboard property (or group of billboard properties) is converted into a multiple of the subject's annual anticipated effective gross advertising income (i.e., gross advertising income less allowances for vacancy [periods when the billboard space is not rented] and advertising agency commissions). To generate a value indicator for the subject billboard property (or group of billboard properties), the derived multiplier is multiplied by the subject billboard property's expected annual effective gross income.

With a group sale, the estimated value for the group being appraised can be allocated to the separate billboard properties in the group using a generally accepted measure of productivity for a billboard property such as average Daily Effective Circulation (DEC).[7] An income multiplier derived from a group sale can also be adjusted such that it can be applied to an individual billboard property.

The derived income multiplier should be based on the taxable value of the billboard property (or properties) only. Thus, when deriving an income multiplier the following adjustments should be made to the reported sale price, as applicable:

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[6] See Revenue and Taxation Code section 402.5; Property Tax Rule 4; and AH 502, Chapter 3. In the case of a billboard property, if the ground lease does not reflect market rent, it is also necessary to adjust the comparable sales data for this element.

[7] Daily Effective Circulation (DEC) is a statistical measurement of a billboard's traffic volume, or exposure. The Traffic Audit Bureau provides independent, audited DEC information for all billboards entered into its system. The information is used by both billboard companies and advertisers.

Convert any noncash consideration accepted by the seller as all or part of the purchase price to its cash equivalent amount.

Remove the estimated value of any real property included in the sale that is not part of the billboard plant (i.e., billboard properties) from the reported sale price (e.g., an office building or shop/maintenance facility).

Remove the estimated value of any personal property included in the sale from the reported sale price (e.g., equipment, furnishings, automobiles).

Remove the estimated value of any intangible assets or rights (i.e., enterprise value) included in the sale from the reported sale price.

INCOME APPROACH—DIRECT CAPITALIZATION

In the income approach, rental income is generally preferred to operating income, since operating income may be attributable, in part, to nontaxable sources. With billboard properties, rental data are difficult to obtain because billboard properties are rarely leased. Since rental income is typically unavailable, operating income is often used.

With operating income, an income attributable to the billboard property (or group of billboard properties) is imputed by taking the expected total advertising income, or operating income, generated by the subject billboard property (or group of billboard properties), excluding any amount of income that derives from nontaxable sources (such as the billboard use permit and any other elements of enterprise value), [8] and further deducting all allowed expenses (i.e., items of "gross outgo" in Property Tax Rule 8(c)). Allowed expenses include appropriate deductions for vacancy and collection loss, commissions to advertising agencies, and operating expenses. Operating expenses include ground rent, painting and production (poster installation), maintenance, electricity, management, insurance, and recurring permit fees.

After net income is determined, an appropriate capitalization rate must be developed. An overall capitalization rate can be derived from a sale of an individual billboard property (or group of billboard properties) and applied to the subject billboard property (or group of billboard properties) to generate the value indicator. Again, the value indicator for a group of billboard properties can be allocated to the separate properties within the group using a generally accepted measure of a billboard property's utility, such as Daily Effective Circulation.

INTANGIBLE ASSETS AND RIGHTS

The siting, construction, and operation of billboard properties is regulated by the Outdoor Advertising Act and/or by county or municipal ordinances.[9] The Outdoor Advertising Act or these local laws (or both in some instances) control the issuance of billboard use permits. State and local governments have used these laws to limit the number of billboards in many areas. By regulating (i.e., limiting) the number of billboard use permits, government has increased the value

[8] See AH-502, pp. 150-165.
[9] In regard to the Outdoor Advertising Act, see Business and Professions Code section 5200, et seq.

of existing billboard properties. The value resulting from the scarcity of billboard use permits should be attributed to the use permits and not to the billboard properties.

The billboard use permit is an intangible asset or right under Revenue and Taxation Code section 110(e) that is necessary for the beneficial and productive use of the billboard property. Since the use permit is an intangible asset or right that is not itself assessable, any value attributable to the use permit must not be included in the taxable value of the billboard property.[10] However, since a billboard use permit is necessary to put the land to beneficial and productive use as a billboard site, the land must be assessed and valued by assuming the presence of the use permit.[11]

In addition to the billboard use permit, intangible assets or rights that may need to be considered include relationships between a billboard company and advertisers or advertising agencies; assembled work force of a billboard company; the marketing activities associated with the ownership of multiple billboard properties (e.g., the ability to market billboard display space as "showings"); and company reputation, or "goodwill."

Location must be considered in assessing billboards. The impact of location on the income which a particular billboard generates, or the price at which that billboard sells, can be considerable. This impact results from the "traffic count" or "exposure" that a particular location provides. However, a higher traffic count has little or nothing to do with a particular billboard improvement, but derives from the land on which the billboard improvement is situated (i.e., location). In assessing the billboard property, the value attributable to location should be assigned to the land (i.e., the billboard site) and not to the billboard improvement.

ALLOCATION OF VALUE TO BILLBOARD PROPERTY COMPONENTS

The value of the billboard property should be allocated between the land (i.e., the leasehold interest in the billboard site) and the billboard improvement (i.e., the sign and its foundation) in the following manner.

1. Estimate the value of the billboard property net of the value of intangible assets and rights. This establishes the taxable value that is to be allocated.

2. Estimate the value of the billboard improvement based on its cost new less depreciation.

3. Subtract the estimated value of the billboard improvement from the value of the billboard property and allocate this remainder to the land, or billboard site. In other words, all value of the billboard property in excess of the billboard improvement's depreciated cost should be allocated to the land as a residual. This method of allocation is consistent with the

[10] AH-502, p. 163.
[11] See Revenue and Taxation Code section 110(e); AH 502, pp. 154-155.

> billboard's classification as a fixture and its status as a separate appraisal unit. As a separate appraisal unit, the billboard improvement should be valued separately.[12]
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> The portion of the value of the billboard property that is allocated to the land (i.e., the billboard site) may or may not be assessable depending on the terms of the ground lease. In order to reassess the value allocated to land, a change in ownership of the land under article XIII A ("Proposition 13") must have occurred.[13]

As discussed above, typically there are two interests in the billboard site: (1) the leased fee interest of the ground lessor (i.e., the interest held by the fee owner of the billboard site) and (2) the leasehold interest of the ground lessee (i.e., the interest held by the billboard company's interest). Only the second interest, the leasehold interest in the billboard site, is part of the appraisal unit designated as the billboard property. The value of both interests in land, however, should be included in a single assessment to the owner of the fee interest in land. In other words, a separate land assessment should not be created for the billboard company's leasehold interest in the billboard site. (And as noted, any value attributable to the billboard company's leasehold interest in the billboard site only becomes assessable if there has been a change in ownership of the billboard site.)[14]

[12] Because billboards are fixtures, they must be appraised in accordance with Property Tax Rule 461(e), which provides that, for purposes of decline-in-value determinations, fixtures constitute a separate appraisal unit.

[13] See subdivision (c)(1) of Revenue and Taxation Code section 61 and Property Tax Rule 462.100, subdivisions (a)(1) and (a)(2).

[14] Two other assessment issues concerning billboards should be briefly discussed. First, a number of billboard properties are located within railroad rights of way, raising the jurisdictional question of whether these properties should be state or locally assessed. In general, all property that is owned or used by a state assessee is assessed by the Board. As with other billboard properties, the entire value of the billboard site should be assessed to the fee owner of the billboard site, in this case, the state assessee. Thus, the only component of a billboard property that should be locally assessed is the billboard improvement.

The second issue concerns billboard properties that are also taxable possessory interests. A billboard property that constitutes a taxable possessory interest should be valued as any other taxable possessory interest.