Issue Paper Number **99-049**

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

☐ Board Meeting
☐ Business Taxes Committee
☐ Customer Services Committee
☐ Legislative Committee
☒ Property Tax Committee
☐ Technology & Administration Committee
☐ Other

Proposed Changes to the Unitary Valuation Methods Book

I. Issue

Should staff proposals for change to the ***Unitary Valuation Methods*** book for the 2000 lien date be implemented?

II. Staff Recommendation

Staff recommends that proposals listed in the "Staff Proposal" column of **Attachment 1** be made to the ***Unitary Valuation Methods*** book for the 2000 lien date**.**

III. Other Alternatives Considered

Alternative 1

Make no changes to the ***Unitary Valuation Methods*** book, and calculate value indicators for the 2000 lien date in the same manner as 1999.

Alternative 2

Implement a combination of changes to the ***Unitary Valuation Methods*** book recommended by staff (Staff Proposal, **Attachment 1**), industry representatives (Industry Position, **Attachment 1**) and/or county representatives (County Position, **Attachment 1**) for the 2000 lien date.

IV. Background

On June 23, 1998, the Board's Property Tax Committee met to discuss whether a task force should be created to work on valuation methods and procedures to be used by staff following the expiration of the Master Settlement Agreement (MSA). [1] While a task force was not created, it was the general consensus of the committee that work on the Board's valuation methods and procedures for state-assessed property would be valuable and should be continued on an informal basis. Staff was encouraged to meet with state assessees on the Board's valuation methods. State assessees were encouraged to work with the Board's staff and provide replacement cost information for their respective companies.

Valuation Division staff subsequently prepared a ***Unitary Valuation Methods*** book. This book documented, in detail, the valuation models currently used by staff in the preparation of unitary value indicators. It also provided a logical starting point for future discussions regarding the relevancy of the various models or specific aspects of those models.

Staff analyzed the current value indicator models with consideration given to responses and proposals from interested parties, relevant court decisions, and unitary valuation methods employed by other states. As a result of that process, proposed changes to the contents of the ***Unitary Valuation Methods*** book were developed and staff's proposals were presented to each of six industry groups of state assessees and/or their representatives and to representatives from the counties during September 1999. Written responses were requested from the attendees addressing not only staff's proposed changes, but also any other issues regarding the valuation of unitary property. Staff received thirteen written responses from either individual assessees and/or representatives of industry groups and a combined response from county counsels. Proposals related to the contents of the ***Unitary Valuation Methods*** book recommended by staff, along with the positions of industry and other interested parties are arrayed in **Attachment 1**. Comments and opinions received from assessees and other interested parties relating to issues beyond the scope of the ***Unitary Valuation Methods*** book and staff's responses are listed in **Attachment 2** for the Board's information.

V. Staff Recommendation

A. Description of the Staff Recommendation

The "Staff Proposal" column of **Attachment 1** lists proposed changes to the ***Unitary Valuation Methods*** book. Staff recommends that these changes be made for the 2000 lien date**.**

B. Pros of the Staff Recommendation

- Provides staff with direction to proceed with the preparation of unitary value indicators for lien date 2000 without any anticipated additional filing requirements for state assessees.
- Updates the ***Unitary Valuation Methods*** book and enables staff to comply with valuation policies included in current Board publications.

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[1] The California State Board of Equalization and 58 counties entered into a settlement agreement with AT&T and 26 other cost rate base regulated telephone companies and gas and electric utilities. Under the terms of the agreement, unitary assessments are based on historical cost less depreciation less 25% of deferred tax reserve through the 1999 assessment year. In turn, the utilities agreed to drop all outstanding claims and litigation. The combined value of the companies that are party to the settlement agreement averages 85% of the total assessed value of state-assessed unitary property.

- Adapts valuation methods to reflect a changing regulatory climate, technological advances, changing market forces, etc.

C. Cons of the Staff Recommendation

Redirection of staff resources within the Property Taxes Department will be required to develop new valuation procedures and to provide additional training for appraisers to implement the proposed changes.

D. Statutory or Regulatory Change

None

E. Administrative Impact

Redirection of staff resources within the Property Taxes Department will be required to develop new valuation procedures and to provide additional training for appraisers to implement the proposed changes.

F. Fiscal Impact

1. Cost Impact

Not applicable

2. Revenue Impact

See Revenue Estimate attached.

G. Taxpayer/Customer Impact

No additional reporting requirements are anticipated by adoption of the staff proposals.

H. Critical Time Frames

A Board decision by December 1, 1999 will allow adequate time to implement proposed changes for the 2000 lien date.

VI. Alternative 1

A. Description of the Alternative

Make no changes to the ***Unitary Valuation Methods*** book, and calculate value indicators for the 2000 lien date in the same manner as 1999.

B. Pros of the Alternative

No redirection of staff resources would be needed to revise appraisal templates.

C. Cons of the Alternative

- Could lead to increased appeal workload and risk of litigation in the future.
- Would result in valuation models that are inconsistent with valuation policies included in current Board publications.

- Would continue the use of valuation methods that may not reflect the changing regulatory climate, technological advances, market forces, etc.

D. Statutory or Regulatory Change

Potential increased appeal workload and litigation.

E. Administrative Impact

None

F. Fiscal Impact

Not applicable

1. Cost Impact

Not applicable

2. Revenue Impact

None

G. Taxpayer/Customer Impact

No additional reporting requirements would be imposed by a decision to adopt Alternative 1.

H. Critical Time Frames

A Board decision by December 1, 1999 would allow staff ample time to prepare for the 2000 lien date unitary valuation process.

VII. Alternative 2

A. Description of the Alternative

Implement a combination of changes to the ***Unitary Valuation Methods*** book recommended by staff (Staff Proposal, **Attachment 1**), industry representatives (Industry Position, **Attachment 1**) and/or county representatives (County Position, **Attachment 1**) for the 2000 lien date.

B. Pros of the Alternative

- Would provide staff with direction to proceed with the preparation of unitary value indicators for lien date 2000.
- Would update the ***Unitary Valuation Methods*** book.
- Would adapt valuation methods to reflect changing regulatory climate, technological advances, changing market forces, etc.

C. Cons of the Alternative

- Could require redirection of staff resources within the Property Taxes Department to develop new valuation procedures and to provide additional training for appraisers to implement the proposed changes.
- Could increase filing requirements for state assessees.

- Could lead to valuation models inconsistent with valuation policies included in current Board publications.

D. Statutory or Regulatory Change

None

E. Administrative Impact

Adoption of certain proposals in the "Industry Position" column and "County Position" column of **Attachment 1** would require redirection of staff resources within the Property Taxes Department to perform additional calculations during the unitary valuation process.

F. Fiscal Impact

1. Cost Impact

Not applicable

2. Revenue Impact

See Revenue Estimate attached.

G. Taxpayer/Customer Impact

Additional reporting requirements would be placed upon state assessees if certain proposals in the "Industry Position" column or the "County Position" column of **Attachment 1** were adopted.

I. Critical Time Frames

A Board decision by December 1, 1999 would allow staff adequate time to implement proposed changes for the 2000 lien date.

Prepared by: Property Taxes Department, Valuation Division

Current as of: November 3, 1999

Attachment 1

Issues for Board Decision

Unitary Valuation Methods Book

Item No.	Issue	Staff Proposal	Industry Position	County Position	Staff Position/Response
HISTORICAL COST LESS DEPRECIATION					
1	Should staff's proposed method of adjusting for deferred federal income taxes (DFIT) in the Historical Cost Less Depreciation (HCLD) indicator be implemented?	The proper amount of the deduction from the HCLD indicator is the difference between the amount of the DFIT liability and the present value of the investment allowed to be recovered through the rates.	100% of DFIT is the proper deduction.	No deduction should be made for DFIT.	Staff's proposed treatment is prescribed by the AH 502 (page 146).
2	Should additional or extraordinary obsolescence be deducted in the HCLD indicator?	Continue the current practice of following Property Tax Rule 3(d) which requires that only regulatory depreciation be used in the calculation of the HCLD indicator.	Obsolescence should be allowed even if regulators have not recognized the impairment to earnings.		Property Tax Rule 3(d) requires that only regulatory depreciation be used in the calculation of the HCLD indicator.
3	Should a value be added to the HCLD indicator for the free use of public rights-of-way by telephone companies?[1]	Continue the current practice of making no addition to the HCLD indicator for the free use of public rights-of-way by telephone companies.		An addition should be made to the HCLD indicator for the value of the free use of public rights-of-way by telephone companies.	No adjustment should be made. No costs or expenses are associated with these rights-of-way, either for the current or any future telephone company that possesses these rights. Purchasers would not pay for rights that they currently possess.
REPLACEMENT / REPRODUCTION COST LESS DEPRECIATION (RCLD)					
4	Should the capitalization rate used to value the possessory interest additive to the cost approach include an income tax component?[2]	The capitalization rate used to value the possessory interest additive to the cost approach should not include an income tax component.	Possessory interest land parcels should be valued using a capitalization rate that includes a component for income taxes.		A component for income taxes is not necessary because the government agencies that determine the level of the rental and receive the payments are not subject to income taxes.
5	Should a line be added for deducting additional or extraordinary obsolescence in the RCLD indicator?	A line should be added for deducting additional or extraordinary obsolescence to the RCLD indicator.	This is an industry proposal, with which staff agrees.		

[1] This item also applies to the RCLD value indicator.
[2] This item also applies to the HCLD value indicator.

Issues for Board Decision

Item No.	Issue	Staff Proposal	Industry Position	County Position	Staff Position/Response
6	Should the Unitary Valuation Methods book include language regarding additional functional obsolescence?	Add language to the Unitary Valuation Methods book recognizing that the cost to carry excess operating expenses over the remaining economic life of the existing assets, and the cost to cure, are among the appropriate measures to recognize additional functional obsolescence.	This is an industry proposal, with which staff agrees.		Staff follows the direction of Board Member Andal's February 1997 memo regarding standards for documenting claimed obsolescence.
CAPITALIZED EARNINGS ABILITY (CEA)					
7	Should the perpetual life model be the primary CEA model calculated by staff?	The perpetual life model should be the primary CEA model calculated for all industry groups.	Agree	Agree	
8	Should the use of the limited life CEA model be restricted to certain specific factual situations?	Restrict the use of the limited life CEA indicator calculation to situations in which the life of a unitary property is restricted by physical or economic factors.	Agree		A limited life CEA model is indicated in those specific situations where the life of a unitary property is restricted by physical or economic factors (e.g. a pipeline serving a rapidly depleting oil field). The limitation will determine the remaining life of the property instead of the composite life of the component assets.
9	Should staff's proposed method for determining the amount of the allowance for capital replacements in the perpetual life CEA model be implemented?	The typical allowance for capital replacements should be determined by book depreciation for HCLD ratebase regulated companies and for other companies by replacement cost new (RCN) divided by weighted average life new of assets, if this information is available. Staff will consider company specific information from assessees that indicates that staff's standard method provides an inaccurate provision for capital replacement expenditures.	Although some assessees agree with staff's proposal, others request that actual capital expenditures be deducted from the income stream.	The capital replacement allowance used in the perpetual life CEA example in the Unitary Valuation Methods book is excessive.	Deducting actual capital expenditures as proposed by some assessees may provide an excessive amount of capital replacement expenditures. Actual expenditures may include amounts for growth, expansion, and increases in capacity. Although the example shown on page 40 of the Unitary Valuation Methods book is based on an actual company, it does not apply to companies with longer-lived assets.

Issues for Board Decision

Item No.	Issue	Staff Proposal	Industry Position	County Position	Staff Position/Response
10	Should the Level Annuity model be deleted from the Unitary Valuation Methods book?	The Level Annuity model should not be deleted from the Unitary Valuation Methods book.	The level annuity model should be deleted from the Unitary Valuation Methods book.		The level annuity method may be applicable in those restricted situations where staff proposes to use a limited life CEA.
11	Should the use of the "J" Factor be discontinued unless the unit is comprised entirely of new property?	Discontinue the use of the "J" Factor in the calculation of the income tax component of the CEA, unless the unit is comprised entirely of new property.	Agree		The tax life of property in the unit and the remaining economic life of used property are similar. The "J" Factor calculation has little effect on the income tax component and eliminating it would simplify the calculation.
12	Should staff's proposed method of determining a deduction for working cash and other nontaxable intangibles be implemented?	Deduct working cash and other nontaxable intangibles by imputing income to the deductible item at the basic capitalization rate plus an income tax component. Previously, income was imputed at the basic capitalization rate only.	Agree		Property Tax Rule 8 (e) prescribes staff's proposed treatment.
13	Should the Unitary Valuation Methods book contain criteria for identifying and deducting intangibles?	The Unitary Valuation Methods book should not contain criteria to identify and deduct intangibles.	The Unitary Valuation Methods book should include acceptable criteria to identify and deduct intangibles.		AH 502 describes general criteria for identifying and deducting intangibles. Specific, uniform and consistent criteria are not feasible because of the different environments, regulatory climates, markets, etc. among the various assessees.
14	Should the current practice of adding growth plant construction work in progress (CWIP) to the CEA indicator be discontinued?	Growth plant CWIP should be added to the CEA indicator.	Growth plant CWIP should not be added to the CEA indicator.		Growth plant CWIP must be added since staff's appraisal income does not include earnings from growth CWIP.
15	Should the practice of adding future use property to the CEA indicator be limited to those cases where the property is not included in ratebase?	The practice of adding future use property to the CEA indicator should be limited to those cases where the property is not included in ratebase.	This is an industry proposal, with which staff agrees.		

Issues for Board Decision

Item No.	Issue	Staff Proposal	Industry Position	County Position	Staff Position/Response
16	Should staff's current practice of adding the value of unitary possessory interests to the CEA indicator be continued?	Continue the current practice of adding the value of unitary possessory interests to the CEA indicator.	Possessory interests are already reflected in the CEA value and should not be added.		Possessory interest payments are allowed as expenses. This excludes the value from the CEA indicator. An additive is required to include the value of only the term of possession. The reversionary interest is not taxable.
17	Should staff's proposal that the present value of the recovery of property-related transition costs be added to the CEA indicator be implemented?	The present value of the recovery of property-related transition costs should be added to the CEA indicator.	Transition cost recovery should not be added to the CEA indicator.		The future revenues to be collected for this taxable property are not reflected in the perpetual life CEA indicator. The present value of the recovery of property-related transition costs is a proper additive to the CEA indicator.
18	Should the current practice of using the combined expected <u>marginal</u> income tax rate of a <u>prospective purchaser</u> be continued?	Continue the current practice of using the combined expected <u>marginal</u> income tax rate of a <u>prospective purchaser</u>.		The <u>effective</u> income tax rate of the <u>assessee</u> should be used to calculate the income tax component.	Staff's current practice conforms with AH 502 (page 179, footnote 175). A market value appraisal assumes the sale of the property to a prospective purchaser. The actual income taxes paid by an assessee may be higher or lower than the taxes a prospective purchaser would expect to pay.
19	Should "apportioning intangible values between taxable and nontaxable properties" and "reconciliation of value indicators" be removed from the Unitary Valuation Methods book as appropriate methods to remove nontaxable intangibles from the CEA indicator?	"Apportioning intangible values between taxable and nontaxable properties" and "reconciliation of value indicators" should be removed from the Unitary Valuation Methods book (page 112) as appropriate methods to remove nontaxable intangibles from the CEA indicator.	This is an industry proposal, with which staff agrees.		
20	Should the current practice of calculating the Stock and Debt value indicator be continued?	Continue the current practice of calculating the Stock and Debt value indicator.	The Stock and Debt indicator should not be calculated.	The Stock and Debt indicator should be calculated.	The Stock and Debt indicator is an appropriate value indicator pursuant to Property Tax Rule 3(b).
21	Should the current practice of calculating a sales indicator be continued?	Continue the current practice of calculating a sales indicator.	The direct sales approach should be abandoned. Analysis of the sale of a subject property is not proper.		The sales approach is an appropriate value indicator pursuant to Property Tax Rule 3(a).

Issues for Board Decision

Item No.	Issue	Staff Proposal	Industry Position	County Position	Staff Position/Response
MISCELLANEOUS					
22	Should staff's proposed language be substituted for current language in the Unitary Valuation Methods book (page 128)?	Certain language in the glossary of the Unitary Valuation Methods book (page 128)[3] should be revised to reflect changes proposed.	This is an industry proposal, with which staff agrees.		
23	Should all references to the Master Settlement Agreement be removed from the Unitary Valuation Methods book?	All references to the Master Settlement Agreement should be removed from the Unitary Valuation Methods book.	Disagree with certain language included in the Unitary Valuation Methods book pertaining to the Master Settlement Agreement.		
24	Should staff rely on company-supplied values for intangibles?	Continue the current practice of considering company-reported values for intangibles.		Staff should not rely on company-supplied values for intangibles.	Assessing authorities consider assessee reported data to calculate value indicators. All reported data are subject to audit.
Property Classification					
25	Should leased property used in the primary function of a state assessee be classified as unitary?	Leased property used in the primary function of a state assessee should be classified as unitary.	Agree		Past practice was to classify most leased property as nonunitary. Staff proposes to change this practice because this property is used in the state assessee's unitary operations.

[3]Unit Method of Valuation - The technique of valuing ~~an integrated group of assets~~ property operated as a unit in a primary function of the assessee ~~functioning as an economic unit~~ as "one thing" ~~without reference to the value of the component parts~~.
Unitary Operations – income-producing activities engaged in by a public utility that are essential to the provision of public utility services. All ~~assets~~ property owned or used by a public utility that is ~~are~~ needed to provide public utility services is ~~are~~ known as "Unitary Property".

Attachment 2

Issues Beyond the Scope of the Unitary Valuation Methods Book and Other Issues for the Board's Information

Item No.	Subject	Industry Comments	County Comments	Staff Response
REPLACEMENT COST LESS DEPRECIATION				
1	Replacement Cost Less Depreciation indicator	Local exchange telephone assessees state that industry may be able to supply staff with more accurate trending factors and service life data.		Staff will consider any valid information supplied by assessees or any other sources in the valuation of unitary property.
2	All costs necessary to put assets into productive use	An interexchange assessee states that the staff should specifically delineate the cost categories it believes should be adjusted in the Replacement Cost studies supplied by assessees, and how those cost adjustments should be determined.		Staff will be prepared to address this subject after its analysis of company-supplied replacement cost studies is complete. A discussion of all relevant costs to be considered is included in AH 504 starting at page 54.
CAPITALIZED EARNINGS ABILITY (CEA) / CAPITALIZATION RATE				
3	Projected revenue used in the CEA indicator	A wireless telephone assessee states that revenue projected should not include revenue growth due to the addition of future assets.		Agree
4	The use of stabilized or average income in the CEA indicator	Local exchange telephone assessees state that in calculating the CEA indicator, a stabilized or averaged income should be capitalized in accordance with generally accepted appraisal techniques.		Property Rule 8 (c) prescribes the amount to be capitalized as the amount a reasonably well informed buyer would expect the property to yield. This could be a stabilized or average income.
5	CEA indicator - possessory interests	Gas and electric company assessees state that staff's treatment of franchise payments must be consistent with R&T Code section 107.1 and that the staff differentiate between pre-De Luz and post-De Luz payments.		Staff follows R&T Code section 107.1. The property statement currently requests that assessees break out pre-De Luz and post-De Luz payments.
6	CEA - capital structure		The capital structures used by staff are unrealistic.	The prospective purchasers' capital structure is determined each year in the Capitalization Rate Study prepared by staff. The capital structures recommended by staff are based on the market value of debt and equity for representative companies in each industry. Staff complies with Property Tax Rule 8(g)(2).
7	Matching the capitalization rate to the income stream to be capitalized in the CEA indicator.		The basic capitalization rate includes expected inflation. To match the income stream to the capitalization rate, either the projected income should include the effects of inflation or expected inflation must be removed from the basic capitalization rate.	Staff ' s projected income to be capitalized includes expected inflation as well as all other factors. Staff's capitalization rate is extracted from the market and reflects the same factors.

Attachment 2

Issues Beyond the Scope of the Unitary Valuation Methods Book and Other Issues for the Board's Information

Item No.	Subject	Industry Comments	County Comments	Staff Response
8	Income tax component		Staff's treatment of the tax deductibility of debt in the income tax component calculation is not consistent with examples shown in financial texts.	Staff's method and the method cited by the counties produce identical results. The income tax component calculation used by the staff is allowed by AH502 (page 180, footnote 177).
9	Flotation cost adjustment	An interexchange assessee states that the staff's methodology for recognition of flotation costs in the basic capitalization rate is appropriate.	Flotation cost adjustments to the capitalization rate are not appropriate.	Financial texts regard flotation costs as proper consideration in the determination of the cost of capital.
INTANGIBLES				
10	Intangibles		Intangibles should be treated consistent with the IT&T World Communications Inc. v. San Francisco (1985) 37 Cal.3d 859.	Intangibles are deducted from value indicators in accordance with guidelines prescribed in AH 502.
11	Intangible value in the CEA indicator.	Local exchange telephone companies and interexchange companies state that intangibles must be removed from the CEA value.		Intangibles are deducted from the CEA indicator in accordance with guidelines prescribed in AH 502.
12	Subtracting nontaxable intangible assets in the CEA indicator	Local exchange telephone assessees state that the CEA approach must account for and subtract all value attributable to nontaxable intangible assets.		Intangibles are deducted from the CEA value in accordance with guidelines prescribed in AH 502.
13	Comparative sales indicator	A common carrier pipeline company states that intangibles must be removed from the comparative sales indicator.		Intangibles are deducted from the sales indicator in accordance with guidelines prescribed in AH 502.
VALUE RECONCILIATION				
14	Suggested language addition to the Unitary Valuation Methods Book – CEA indicator	An interexchange assessee requests language stating "The income approach is unreliable and is not used when its use is likely to result in the valuation of nontaxable assets in addition to taxable property. The approach is particularly unreliable… "		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
15	Suggested language addition to the Unitary Valuation Methods Book – Stock & Debt indicator	An interexchange assessee requests language stating "The Stock and Debt approach is unreliable and is not used when its use is likely to result in the valuation of nontaxable assets in addition to taxable property. The approach is particularly unreliable…"		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.

Attachment 2

Issues Beyond the Scope of the Unitary Valuation Methods Book and Other Issues for the Board's Information

Item No.	Subject	Industry Comments	County Comments	Staff Response
16	Replacement Cost New Less Depreciation (ReplCLD) indicator	Local exchange telephone assessees state that when (1) competition and open entry replace exclusive markets, (2) rate regulation is relaxed or eliminated, or (3) regulatory oversight and ratemaking are based on replacement cost calculations, ReplCLD becomes the most reliable measure for valuing public utility property.		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
17	Use of the CEA indicator	Local exchange telephone assessees state that the CEA approach should be preferred when the subject property is not capable of reproduction or replacement.		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
18	Reliability of the CEA indicator	Local exchange telephone assessees state that the CEA model is unreliable to the extent that it fails to measure market related economic obsolescence attributable to the subject property.	A properly applied income approach is often the best value indicator.	Obsolescence is one of many factors affecting the reliability of a value indicator. Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
19	Reliability of the CEA indicator	A wireless telephone company states that the CEA is unreliable because of the presence of intangibles.		Intangibles are deducted from the CEA indicator in accordance with guidelines prescribed in AH 502. Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
20	HCLD value indicator for railroads	Railroad assessees concur with staff that the HCLD methodology is not appropriate for Railroads.		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
21	Reproduction Cost Less Depreciation (ReproCLD) value indicator for railroads	Railroad assessees concur with staff that the ReproCLD methodology is not appropriate for Railroads.		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
22	ReplCLD indicator for wireless telephone companies	A wireless telephone company requests that wireless telephone companies be value based on the ReplCLD.		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
23	ReproCLD indicator for ratebase regulated companies.	Gas and electric companies and a common carrier pipeline company request that the ReproCLD indicator not be used to value their regulated property.		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.

Issues Beyond the Scope of the Unitary Valuation Methods Book and Other Issues for the Board's Information

Item No.	Subject	Industry Comments	County Comments	Staff Response
24	ReplCLD indicator for interexchange companies	Interexchange telephone companies state that the ReplCLD indicator should be the primary means to value their property.		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
25	Weighting of the CEA indicator	A common carrier pipeline company requests that no weight be given to the CEA indicator. 100% weighting for the ratebase indicator is preferred.		Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
26	Weighting of the Stock and Debt indicator	Many assessees request no weight be given to the Stock and Debt indicator.	The Stock and Debt indicator is a valid valuation approach and should be considered.	Value reconciliation is beyond the scope of the Unitary Valuation Methods book. Reconciliation issues are addressed in chapter 5 of AH 502.
MISCELLANEOUS				
27	AH 502	A wireless telephone company requests that the staff follow the guidelines established in the AH 502.		Staff follows the guidelines of the AH 502 as well as all other applicable sections of the Assessors' Handbook.

BOARD OF EQUALIZATION
REVENUE ESTIMATE

ISSUE #99-049
Proposed Changes to the Unitary Valuation Methods Book

Proposal

Board staff has proposed changes to the valuation methods for state-assessed property.

Background, Methodology, and Assumptions

Valuation Division staff has been developing valuation methods and procedures to be used following the expiration of the Master Settlement Agreement (MSA) of the Board and the 58 counties with cost rate base regulated telephone companies and gas and electric utilities. Under the terms of the agreement, the unitary assessments of these companies were based on historical cost less depreciation (HCLD) less 25 percent of deferred income taxes (DFIT) through the 1999 assessment year.

DFIT Adjustment

There are many changes in the proposals offered by staff, industry, and the counties. Only a few of these should have a revenue effect. The area of disagreement with, by far, the greatest revenue impact is the adjustment of the HCLD value indicator, or other Ratebase indicator, for DFIT. Under the staff proposal, the HCLD or other Ratebase indicator would be adjusted for DFIT with a company specific calculation that recognizes the time value of money. Under the industry proposal, 100 percent of DFIT would be deducted. Under the counties' proposal, no deduction would be made for DFIT.

This treatment will most affect the valuation of the cost rate base regulated telephone companies and gas and electric utilities and rate base pipelines. In 1999, these companies comprise over 75 percent of the value on the state-assessed roll; their deferred income tax reserves totalled $7.44 billion. The DFIT adjustment used for the 1999 Board Roll amounted to $1.88 billion. The estimated deduction under the staff proposal is $3.26 billion.

Adjustment to Possessory Interests Capitalization Rate

Another issue with potential revenue impact is whether possessory interest land parcels should be valued using a capitalization rate that includes a component for income taxes. Board staff proposes no changes in the current practices in valuing possessory interests. Industry supports the usage of a capitalization rate with the income tax component to value them. In 1999, the total assessed value of possessory interests on the Board roll amounted to $125.8 million. Assuming that the average term of each possessory interest is between 10 and 20 years, staff estimates that the valuation method proposed by industry would result in assessed values that are $27.5 million to $37.5 million lower than under current practice.

Revenue Summary

DFIT Adjustment

Under the DFIT adjustment proposed by staff, property taxes at the basic one percent property tax rate would be about $13.8 million [($1.88 billion - $3.26 billion) x 1 percent] lower annually than under current practice. Property taxes under the industry proposal would be $55.6 million [($1.88 billion - $7.44 billion) x 1 percent] annually less than under current practice. Property taxes under the counties' proposal would be $18.8 million ($1.88 billion x 1 percent) higher than under current practice.

Adjustment to Possessory Interests Capitalization Rate

If state-assessed possessory interest land parcels were valued using a capitalization rate adjusted for income taxes as proposed by industry, property taxes at the basic one percent property rate for these possessory interests would be between $275,000 and $375,000 lower annually than under current practice.

Qualifying Remarks

DFIT Adjustment

This estimate is based on property assessed for the 1999 roll. It does not reflect additions or deletions since the January 1, 1999 lien date. As a result of the restructuring of the electrical energy industry in California, the electric utilities in the last two years have sold or closed virtually all of their electrical generation facilities that are not nuclear or hydroelectric. After the sales, these facilities shift from state assessment to local assessment. The initial part of this shift was reflected as of the 1999 lien date; the rest of the sales should be reflected on the January 1, 2000 lien date. It is possible in the future that the nuclear and hydroelectric generation facilities will also be sold by the electric utilities.

Also, this estimate assumes that the subject properties will be valued using only the HCLD value or other Ratebase indicator. With the expiration of the MSA, the unitary assessments for these properties may be based in part on other valuation methods.

Preparation

This revenue estimate was prepared by Aileen Takaha Lee, Statistics Section, Agency Planning and Research Division. The estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division, and by Mr. Harold Hale, Chief, Valuation Division, Property Taxes Department. For additional information, please contact Ms. Lee at 445-0840.

Current as of October 28, 1999.