Appeal: 01-0866
Tax Type: Centrally Assessed Property
Tax Year: 2001

BEFORE THE UTAH STATE TAX COMMISSION

	)	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION
Petitioners,	)	
vs.	)	Appeal No.
PROPERTY TAX DIVISION OF THE UTAH STATE TAX COMMISSION,	)	Tax Years:
	)	Judge:
Respondent.	)	

Presiding:
Mr. G. Blaine Davis, Administrative Law Judge
Ms. Pam Hendrickson, Commission Chair
Mr. Palmer DePaulis, Commissioner
Mr. Mark Johnson, Commissioner

For Petitioner:

For Respondent:

For the Counties:

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on a proffered record. because the parties represented to the Commission that the issues in this case were substantially the same as those in the case. That proffered record for the January 1, 2001, lien date consists of the following:

1. The transcript and all exhibits admitted into evidence as part of the as representative of the positions the parties would take in the proceeding;

2. The original assessment dated May 1, 2001;

3. valuation of (dated September 7, 2001);

4. November 23, 2001, revised supplement to 2001 appraisal based upon Tax Commission Decision for tax year (7 pages);

5. analysis of recent sales of

6. explanation of revised 2001 appraisal (6 pages);

7. review appraisal of as of – January 1,

8. Fair Market Value appraisal of (November 25,);

9. appraisal of ; and

10. Deposition of held November 26,

Based upon the oral and written pleadings, the evidence, the testimony and the exhibits presented at the formal hearing, the Tax Commission makes and enters its:

FINDINGS OF FACT

1. The tax type is a fee in lieu of ad valorem property tax ("Fees" or "Fees in Lieu").

2. The valuation lien date is January 1, 2001.

3. The subject property is

4. is subject to central assessment by the Tax Commission on the lien date pursuant to the provisions of

7. The management of [redacted] is under [redacted]

Appraisal Evidence

37. The Division's original 2001 assessment set the value of [redacted] at $[redacted] (Revised Notice of Assessment dated May 14, 2001.).

38. At the hearing, the Division submitted an appraisal prepared by [redacted] contending that the value is $[redacted]

39. [redacted] submitted an appraisal prepared by [redacted] contending that the value is $[redacted]

40. The Counties submitted an appraisal prepared by [redacted] contending that the value is $[redacted]

41. The Division and [redacted] agree the fair market value should be derived under Rule 16 through a historical cost approach based on the net book value, and on an imputed income approach based on the net book value cost indicator of value.

42. The Counties advocate other approaches. [redacted] performed a trended original cost for his cost approach. This is a form of reproduction cost. Reproduction cost is not the cost approach contained in Rule 16 or preferred by Rule 62. The cost approach continained in Rule 16 and preferred by Rule 62 is Historical Cost Less Depreciation. [redacted] also performed four market indicators of value not found in Rule 16. In addition, [redacted] did not perform an income approach. Rule 16 requires an income approach to be performed.

43. The Division presented an appraisal prepared by [redacted] a licensed appraiser in the State of Utah, [redacted]

[redacted] A summary of the appraisal of [redacted] is as follows:

	Weight	
Cost Indicator (Net Book Value of	70%	
Income Indicator CF k-g	30%	
NOI = 136,848,845 (WACC) k = 8.81% Debt = 3.38% Equity = 5.43% g = 2.00% (Forecast Long - Term Inflation)		
Market Value of		
Locally Assessed Vehicles		
Market Value Less Vehicles		
Less Municipal Exemption		
Rounded Taxable Value		

44. prepared an addendum dated November 23, 2001, strictly using data where the Commission adopted data in its Decision. application of data to the Commission's Decision derives the following:

	Weight	
Cost Indicator (Net Book Value of	70%	
Income Indicator	30%	

CF
k-g

NOI = 125,210,357
(WACC) k = 9.12%
Debt = 3.69%
Equity = 5.43%

g = 0.00%
(Forecast Long - Term Inflation)

Market Value of
Locally Assessed Vehicles
Market Value Less Vehicles
Less Municipal Exemption
Rounded Taxable Value

45. [redacted] prepared an analysis of the Commission's [redacted] decision, as applied to the [redacted] assessment of [redacted] his analysis derived the following:

	Weight	
Cost Indicator	70%	[redacted]
(Net Book Value of [redacted]		
Income Indicator	30%	[redacted]

CF
k-g

NOI = 152,445,500

(WACC) k = 8.09%

Debt = 6.43%

Equity = 8.99%

g = 0%

(Forecast Long - Term Inflation)

Market Value of [redacted]

Locally Assessed Vehicles

Market Value Less Vehicles

Less Municipal Exemption

Rounded Taxable Value

46. The Commission finds that [redacted] has properly applied the [redacted] decision to the [redacted] assessment.

47. The appraisal of [redacted] presented at the hearing made three material changes from the original [redacted] assessment, as follows:

a. Interest and overhead costs associated with the construction of [redacted] provided by [redacted] were added to the cost approach. (Exhibit 4, cover letter and page 16.)

b. A working capital adjustment was made to the income approach.

c. Incorrect net operating income calculations for two of the guideline companies used to impute income for [redacted] were corrected.

48. Like [redacted] attempted to value [redacted] under Rule 16 by weighting a historical cost approach based on net book value (adjusted for obsolescence), and on an imputed income approach.

49. [redacted] appraisal differs from [redacted] in the following material ways:

a. It removes deferred federal income taxes from the cost approach as obsolescence, specifically economic obsolescence.

b. It removes the depreciated cost of [redacted] from the cost approach as obsolescence.

c. It does not include in [redacted] .08% of the total costs spent on [redacted] in general allocated overhead costs that [redacted] allocated to [redacted] from its general expenses.

d. It uses a growth rate of 0% rather than 2.0%.

e. It adds a size premium to the cost of equity.

f. It uses a Baa bond rating rather than an Aaa bond rating to determine the cost of debt.

g. It uses earnings growth instead of dividend growth to determine the growth rate under the Dividend Growth Model.

h. It removes impact alleviation payments from the overall value as intangible property prepayments.

i. [redacted] are deducted from the reconciled value rather than from the cost approach.

50. Based upon those assumptions, [redacted] estimated the value of the [redacted] property as follows:

	Weight	
Cost Indicator (Impacted Net Book Value of [redacted]	40%	[redacted]
Traditional Income Model $\frac{CF}{k-g}$	24%	[redacted]
DCF Model NOI = RB x ROR	36%	[redacted]
(WACC) k = 9.28% Debt = 2.45% Equity = 6.83%		
Market Value of [redacted]		[redacted]
Value of nontaxable Items		[redacted]
Market Value Less Nontaxable Items		[redacted]
Less Municipal Exemption		[redacted]
Rounded Taxable Value		[redacted]

50. The approach of [redacted] for the County, is significantly different than that of the other two appraisers.

51. [redacted] does not follow Rule 16. ([redacted] Deposition, p. 17, lines 17-18.) He performed a trended original cost for his cost approach. This is a form of reproduction cost. Reproduction cost is not the cost approach outlined by Rule 16 or preferred by Rule 62. The cost approach outlined by Rule 16 and preferred by Rule 62 is Historical Cost Less Depreciation. [redacted] also performed four market indicators of value not found in Rule 16. In addition, [redacted] did not perform an income approach. ([redacted] Appraisal.) Rule 16 requires an income approach to be performed.

52. Based upon those assumptions, [redacted] estimated the value of the [redacted] property as follows:

	Weight	
Cost Idicator	75%	[redacted]
Sales of Comparable Coal Assets		
Market to Revenue Ratio	5%	[redacted]
Market to Profit Ratio		
Sales Announcement by [redacted]		
Market to Gross Book	10%	[redacted]
Market to Net Book	5%	
Reconciled Value of Utah Assets (rounded)		[redacted]
Less Motor Vehicles		
Total Taxable Value of [redacted]		[redacted]

APPLICABLE LAW

1. The tax in question is a fee in lieu of ad valorem property tax that is assessed on [redacted] property. [redacted]

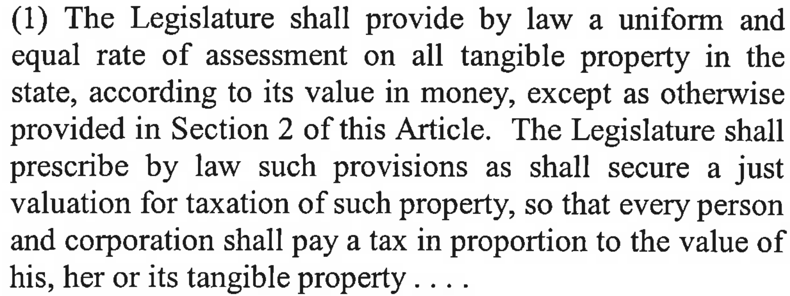
[redacted]

3. The Utah Constitution mandates that all tangible property in the state shall be taxed as follows:

> All tangible property in the state, not exempt under the laws of the United States, or under this Constitution, shall be taxed at a uniform and equal rate in proportion to its value, to be ascertained as provided by law.

Utah Const. Article XIII, Section 2(1).

4. The Utah Constitution also requires the Legislature to enact provisions to equalize the tax burdens:



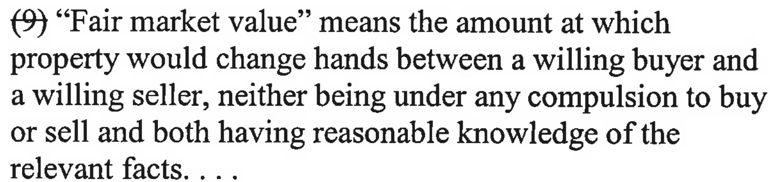
> (1) The Legislature shall provide by law a uniform and equal rate of assessment on all tangible property in the state, according to its value in money, except as otherwise provided in Section 2 of this Article. The Legislature shall prescribe by law such provisions as shall secure a just valuation for taxation of such property, so that every person and corporation shall pay a tax in proportion to the value of his, her or its tangible property . . . .

Article XIII, Section 3(1).

5. Consistent with the Constitutional provisions to tax all property at its fair market value, the Legislature enacted Utah Code Ann. § 59-2-103 (2000) which provides as follows:

> (1) All tangible taxable property shall be assessed and taxed at a uniform and equal rate on the basis of its fair market value, as valued on January 1, unless otherwise provided by law.

6. Utah Code Ann. § 59-2-102(12) (2000) defines "fair market value" in relevant part, as follows:



> ~~(9)~~ "Fair market value" means the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts. . . .

9. Rule R884-24P-62 (Rule 62) governs the valuation of regulated utilities and defines DFIT; and provides as follows:

> A. Definitions:
> 1. "Attributes" of property include all defining characteristics inseparable from real property and tangible personal property, such as size, location and other attributes inherent in the property itself.
> 2. "Cost regulated utility" means any public utility assessable by the Commission pursuant to Section 59-2-201, whose allowed rates are determined by a state or federal regulatory commission by reference to a rate of return applied to rate base where the rate of return and rate base are set by the regulatory body.
> 3. "Depreciation" is the loss in value from any cause. There are two distinct types of depreciation encountered in the appraisal of properties subject to this rule: accounting depreciation and appraisal depreciation. Accounting depreciation is often called "book depreciation" and is generally calculated in accordance with generally accepted accounting principles or regulatory guidelines. Appraisal depreciation is the total loss in property value from any cause. There are three recognized types of appraisal depreciation: physical deterioration, functional obsolescence and external obsolescence. Physical deterioration is the physical wearing out of the property evidenced by wear and tear, decay and structural defects. Physical deterioration includes the loss in value due to normal aging. Functional obsolescence includes the loss in value due to functional deficiencies or inadequacies within the property depicted as the inability of the property to perform adequately the functions for which it was originally designed. External (economic) obsolescence is the loss in value from causes outside the boundaries of the property and is generally incurable. Appraisal depreciation is often called "accrued depreciation."
> 4. "Fair market value" means the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts. Fair market value reflects the value of property at its highest and best use, subject to regulatory constraints.
> 5. "Property which operates as a unit" or "unitary property" means property that is functionally or physically integrated in operation or construction and functions as an economic unit or "one thing."
> 6 "Rate Base" means the aggregate account balances reported as such by the cost regulated utility to the applicable state or federal regulatory commission.
> 7. "State Assessed Utility and Transportation Properties" include all property which operates as a unit across county lines, if the values must be apportioned among more than one county or state; all operating property of an airline, air charter service, and air contract service; and all property of public utilities as defined in Utah Code Ann. Section 59-2-102(21). For

property tax valuation purposes, these properties may generally be classified as telecommunication properties, energy properties, and transportation properties, some of which may be cost regulated utilities.
a. "Telecommunication properties" means all telephone properties, including local exchange carriers, local access providers, long distance carriers, cellular telephone or personal communication service (PCS) providers and pagers and other similar type properties that operate as a unit across county lines and are assessable by the Commission pursuant to Section 59-2-201.
b. "Energy properties" include the operating property of natural gas pipelines, natural gas distribution companies, liquid petroleum products pipelines, and electric corporations, including electric generation, transmission, and distribution companies, and other similar type entities and are assessable by the Commission pursuant to Section 59-2-201.
c. "Transportation properties" means all airlines, air charter services, air contract services, including major and small passenger carriers and major and small air freighters, long haul and short haul line railroads, and other similar type properties that operate as a unit across county lines and are assessable by the Commission pursuant to Section 59-2-201.
8. "Taxable Property" means property that is subject to assessment and taxation according to its value but does not include intangible property. Intangible property is property that is capable of private ownership separate form tangible property and includes moneys, credits, bonds, stocks, representative property, franchises, licenses, trade names, copy-rights, and patents.
B. General Valuation Principles. State assessed utility and transportation properties shall be assessed at fair market value for property tax purposes based on generally accepted appraisal theory and the provisions of this rule.
1. Taxable Property and Unit Methodologies. All taxable property, as defined in this rule, is subject to assessment, and if the property operates together as a unit, the assemblage or enhanced value attributable to the taxable property operating together should be included in the assessed value. The value attributable to intangible property must, when possible, be identified and removed from value when using any valuation method and before that value is used in the correlation process.
a. The preferred methods to determine the fair market value for all state assessed utility and transportation property are a cost indicator and a yield capitalization income indicator.
b. Other generally accepted appraisal methods may also be used when it can be demonstrated that such methods are necessary in order to more accurately estimate the fair market value, which includes assemblage or enhanced value, of properties that operate together as a unit.
c. The direct capitalization income method and the stock and debt market method may tend to capture the value of intangible property, as defined in this rule, at higher levels than other methods. To the extent such

intangible property cannot be identified and removed, relatively less weight shall be given to such methods in the correlation process, as set forth in Section B.5.

d. No final estimate of value will be imposed or considered unless the weighting percentages of the various value indicators used to correlate the final estimate of value are disclosed in writing. Disclosure of the weighting percentages also includes a written explanation describing why a party weighted the particular indicators of value by the percentages so indicated.

e. A party may challenge a final estimate of value by proposing changes to the application of a methodology, by proposing a different valuation methodology or weighting formula, or by presenting any other evidence or argument that establishes a more accurate final estimate of value. A challenge to a final estimate of value will be considered effective only if the proposed valuation methodology or weighting formula demonstrates, by a preponderance of the evidence, that it establishes a more accurate estimate of fair market value.

2. Cost Indicator. Cost is relevant to value under the principle of substitution, which states that no prudent investor would pay more for a property than the cost to construct a substitute property of equal desirability and utility without undue delay. Generally a cost indicator may be developed under one or more of the following approaches; replacement cost new less depreciation ("RCNLD"), reproduction cost less depreciation ("Reproduction Cost"), and historic cost less depreciation ("HCLD").

a. RCNLD. Replacement cost is the estimated cost to construct, at current prices, a property with utility equivalent to that being appraised, using modern materials, current technology and current standards, design, and layout.

b. Reproduction Cost. Reproduction cost is the estimated cost to construct, at current prices, an exact duplicate or replica of the property being assessed, using the same materials, construction standards, design, layout and quality of workmanship, and embodying all the deficiencies, superadequacies, and obsolescence of the subject property. Reproduction cost shall be adjusted for appropriate depreciation.

c. HCLD. The HCLD approach is the historic cost less depreciation. Depending upon the industry, it may be appropriate to trend HCLD to current costs. Only trending indexes commonly recognized by the industry may be used as a trending adjustment to HCLD.

d. In the mass appraisal environment for state assessed utility and transportation property, RCNLD is impractical to implement. The preferred cost indicator of value is HCLD. A party may challenge the use of HCLD by proposing a different cost indicator that establishes a more accurate cost estimate of value. A challenge to the use of HCLD as the cost indicator of value will be considered effective only if the proposed

cost indicator of value demonstrates, by a preponderance of the evidence, that it establishes a more accurate cost estimate of value.

3. Income Indicator. An income indicator recognizes that value is created by the expectation of future benefits to be derived from the property.

a. Yield Capitalization Approach. This income indicator shall be determined by converting future cash flows to present value as of the lien date by capitalizing future estimated cash flows at an appropriate discount rate. The yield capitalization formula is CF/(k-g), where "CF" is cash flow, "k" is the nominal, risk adjusted discount rate, and "g" is the expected future growth of the cash flow in the numerator. Each of these terms is defined below. A discounted cash flow method in which (i) individual years' cash flow are projected, (ii) the formula CF/(k-g) is used to compute terminal value, and (iii) the projected cash flows and terminal value are discounted back to present value; may be used as a substitute income valuation approach for the above yield capitalization approach when the use of a single representative annual cash flow is clearly inappropriate.

(1) Cash Flow ("CF"). Cash flow is restricted to cash flows provided by the operating property in existence on the lien date, together with any replacements intended to maintain, and not expand or modify, the existing capacity or function thereof. Cash flow is calculated as net operating income (NOI) plus noncash charges (e.g., depreciation and deferred income taxes), less capital expenditures and additions to net working capital necessary to achieve the expected growth "g". The cash flows should reflect the cash flows available to pay sources of financing for the assets in existence on the lien date or an equivalent pool of assets. The capital expenditures should include only those expenditures necessary to replace or maintain existing plant and should not include any expenditures intended for expansion or productivity and capacity enhancements. If a taxpayer is unable to separate replacement capital expenditures with reasonable accuracy from expansion capital expenditures, the taxpayer must provide the Property Tax Division sufficient data to adjust the "g" in the yield capitalization formula appropriately. If the taxpayer is unable to provide data to adjust the "g", the Property Tax Division will estimate an adjustment to cash flows or "g" based on the best information available, including industry specific cost indicies. Information necessary for the Property Tax Division to calculate the appropriate cash flow shall be summarized and submitted to the Property Tax Division by March 1 on a form provided by the Property Tax Division. The calculation of Cash Flow may be illustrated by the following formula: CF = NOI + Noncash Charges - Replacement Capital Expenditures - Additions to Net Working Capital

(a) Cash flow is the projected cash flow for the next year and may be estimated by reviewing the last five years' cash flows, forecasting future cash flows, or a combination of both.

(b) If cash flows for a subsidiary company are not available or are not allocated between subsidiary companies on the parent company's cash flow statements, then a method of allocating total cash flows must be developed based on sales, fixed assets, or other reasonable criteria. Whichever criterion is chosen, the subsidiary's total is divided by the parent's total to produce a percentage that is applied to the parent's total cash flow to estimate the subsidiary's cash flow.
(c) If the subject company does not provide the Commission with its most recent cash flow statements by March 1 of the assessment year, Property Tax Division may estimate cash flow using the best information available.

(2) Discount Rate ("k"). The discount rate shall be based upon a weighted average cost of capital considering current market debt rates and equity yields determined by recognized market measurements such as capital asset pricing model ("CAPM"), Risk Premium, Dividend Growth models, or other recognized models. The weighting of debt and equity should reflect the market value weightings of comparable companies in the industry.
(a) Cost of Debt. The cost of debt should reflect the current market (yield to maturity) of debt with the same credit rating as the subject company.
(b) Cost of Equity. In the discount rate, the CAPM is the preferred method to estimate the cost of equity. More than one method may be used to correlate a cost of equity, but only if the CAPM method is weighted at least 75% in the correlation.
(c) CAPM. The CAPM formula is k(e) = R(f) + (Beta x Risk Premium), where k(e) is the cost of equity and R(f) is the risk free rate.
(i) Risk Free Rate ("R(f)"). The risk free rate shall be the current market rate on 20 year Treasury bonds.
(ii) Beta. The beta should reflect an average or value-weighted average of comparable companies. The beta of the comparable companies should be drawn from Value Line or a comparable source. Once a source is chosen, beta should be drawn consistently from this source. However, the beta of the specific assessed property should also be considered.
(iii) Risk Premium. The risk premium shall be obtained from the current Ibbotson Associates study. The risk premium shall be the arithmetic average of the spread between the return on stocks and long term bonds for the most recent 40 years.
(3) Growth Rate ("g"). The growth rate "g" is the expected future growth of the cash flow in the numerator of the formula given in CF/(k-g). If insufficient information is available to the Property Tax Division, either from public sources or from the taxpayer, to determine an appropriate "g", then "g" will be the expected inflationary rate as given by the Gross Domestic Product Price Deflator obtained in Value Line. The inflationary rate and the methodology used to produce it shall be disclosed in a capitalization rate study published by the Commission by February 15 of the assessment year.

b. Direct Capitalization Approach. This is an income approach that converts an estimate of a single year's income expectancy into an indication of value in one direct step, either by dividing the normalized income estimate by an appropriate income capitalization rate or by multiplying the normalized income estimate by an appropriate factor.

4. Market Indicator. The market value of property is directly related to the prices of comparable, competitive properties; or the sale of the specific assessed property when such information is available. The market or sales comparison approach is estimated by comparing the subject property to similar properties that have recently sold. Because sales of state assessed utility and transportation properties are infrequent, the stock and debt approach may be used as a surrogate to the market approach. The stock and debt method is based on the accounting principle which holds that the market value of assets equal the market value of liability plus shareholder's equity.

5. Correlation. When reconciling value indicators into a final estimate of value, the appraiser shall take into consideration the availability, and quality or reliability of data and the strength and weaknesses of each value indicator. The percentage weight assigned to each indicator in the correlation process shall be established, disclosed and explained as set forth in Section B.1.

6. Non-operating property. Property that is not necessary to the operation of the state assessed utility or transportation properties and is assessed by the local county assessor, and property separately assessed by the Property Tax Division, such as registered motor vehicles, shall be removed from the correlated unit value or from the state allocated value.

7. Leased property. All tangible operating property owned, leased, or used by state assessed utilities and transportation companies is subject to assessment.

8. Property Specific Considerations. The Commission recognizes that because of unique differences between certain types of properties and industries, modifications or alternatives to these general cost and yield income indicators, as set forth in Sections C., D., and E., may be required for the following industries: (a) cost regulated utilities, (b) telecommunications properties, and (c) transportation properties.

C. Cost regulated utilities:

1. Cost Indicator. The HCLD approach is the preferred cost indicator of value for cost regulated utilities because it represents an approximation of the basis upon which the investor can earn a return. The HCLD approach is calculated by taking the historic cost less deprecation as reflected in the state assessed utility's net plant accounts, and by then (1) subtracting intangible property, (2) subtracting any items not included in the state assessed utility's rate base (e.g., deferred federal income taxes ("DFIT") and, if appropriate, acquisition adjustments), and (3) adding any taxable items not included in the state assessed utility's net plant account or in rate base.

a. Deferred Federal Income Taxes. DFIT is an accounting entry that reflects a timing difference for reporting income and expenses. Accumulated DFIT reflects the difference between the use of accelerated depreciation for income tax purposes and the use of straight-line depreciation for financial statements. For traditional rate base regulated companies, regulators generally exclude DFIT from rate base, recognizing it as ratepayer contributed capital. Where rate base is reduced by DFIT for rate base regulated companies, DFIT may be removed from HCLD as one type of economic obsolescence.

b. DFIT can be a surrogate measure for economic obsolescence. If a study is prepared that authenticates actual economic obsolescence and is approved by the Commission, the amount of the actual economic obsolescence will be subtracted from HCLD to develop the cost indicator of value.

2. Income indicator. The yield capitalization approach set forth in Section B.3. is the preferred method to derive the income indicator of value.

D. Telecommunications Properties:

1. Cost Indicator. This includes the operating property of local exchange carriers, local access providers, long distance carriers, cellular telephone or personal communication service (PCS) providers and pagers. The HCLD approach set forth in Section B.2., is the preferred method to derive the cost indicator of value.

2. Income Indicator. The yield capitalization approach set forth in Section B.3. is the preferred method to derive the income indicator of value.

E. Transportation Properties. These include the operating property of long haul and short line railroads, commercial airlines, including major and small passenger carriers and major and small air freighters.

1. Railroads.

a. Cost Indicator. The Railroad industry is not rate base regulated and does not typically have a majority of its investment in property of recent vintage. Accordingly, for Railroads, the cost indicator should generally be given little or no weight because there is no observable relationship between cost and fair market value. Cost valuation should be based on trended historical costs less depreciation. Additions should be made for material and supplies and operating leased equipment. Deductions should be made for all capitalized intangible property such as customized computer software. All forms of depreciation should be measured and appropriately deducted.

b. Income Indicator. The yield capitalization approach set forth in Section B.3. is the preferred method to derive the income indicator of value.

2. Commercial airlines, including major and small passenger carriers and major and small air freighters..

a. Cost Indicator. The trended HCLD approach set forth in Section B.2., is the preferred method to derive the cost indicator of value.
b. Income Indicator. The yield capitalization approach set forth in Section B.3. is the preferred method to derive the income indicator of value.
F. This rule shall have an effective date of January 1, 1999.

Utah Admin. Code, R884-24P-62 (1999).

ANALYSIS OF DISPUTED ISSUES

Basic Appraisal Assumptions

Neither the original assessment nor any of the three appraisals use the existing contracts which prevent [redacted] from ever producing power at a profit to compute their respective income indicators of value. The main issue in dispute in this case is which assumption is the most credible and appropriate to produce fair market value.

Each of the parties has adopted an assumption in support of its interpretation of the fair market value standard of Rule 16. The assumptions of the parties are as follows:

A. Property Tax Division's Assumption: What would be the fair market value of [redacted] if it sold to a for-profit entity, on January 1, 2001?

B. Counties' Assumption: [redacted] does not make an assumption about the type of ownership of [redacted] He states that such an assumption is unnecessary because he is appraising the property. ([redacted] Deposition, p.45, lines 14-16.)

C. [redacted] Assumption: What is the value of [redacted] as of January 1, 2001 if it is assumed to have been [redacted]

Central to each of the assumptions is how the parties view [redacted]

A. The Property Tax Division's position is that the contracts are irrelevant to valuing [redacted] because the full "bundle of rights", including all beneficial interests going to the [redacted] is captured in the imputed income approach. This position assumes that by signing lifetime cost of service contracts which do not include a reasonable rate of return on the investment, the beneficiaries of those contracts own a

part of the value of [redacted] which must be included in the total taxable value of [redacted] The core of this position is that one of the rights that must be included in the "bundle of rights" making up the taxable fair market value of the property is the right to make a profit on the property. Rule 16 recognized that concept by requiring "the imputation of an income stream and capitalization rate." Such an imputation of an income stream and capitalization rate would value the full "bundle of rights" and it would not be necessary to give separate consideration to the existing contracts.

B. The position of [redacted] for Petitioner, is that [redacted] bases his appraisal on the existence of [redacted] which he says support the assumption that [redacted] must be treated as [redacted] from its inception because no one would pay fair market value with the [redacted] in place. [redacted] assumes the [redacted] are in place, but assumes they have a rate of return component as would the [redacted]

The Commission finds that [redacted] could sell to an [redacted] on the lien date. We also find that there is insufficient evident to show a reasonable probability that [redacted] would sell to a merchant buyer. The use of the imputed income indicator captures the full value the contracts might have by capturing and valuing the entire bundle of rights.

The major differences between the Property Tax Division (PTD) and [redacted] cost indicator are as follows:

A. [redacted] has imputed a deferred income tax balance in its cost indicator, whereas the position of the Property Tax Division is that the imputation of DFIT, when [redacted] does not actually have any DFIT, is inappropriate.

B. [redacted] has taken an obsolescence adjustment for what it deems to be excess water purchases, whereas the position of the Property Tax Division is that the excess water rights would be allowed in rate base by a regulatory agency because it is held for future use, and therefore it is part of the operating unit.

C. [redacted] has taken an obsolescence adjustment for [redacted] whereas the position of the Property Tax Division is that [redacted] and therefore is part of the taxable operating unit..

D. [redacted] has omitted approximately $[redacted] of indirect construction costs for the [redacted] and the position of the Property Tax Division is that those costs are appropriately part of the taxable operating unit.

There are a number of differences between the income approaches of the Division and [redacted] The most important ones are:

A. [redacted] uses a discounted cash flow (DCF) declining rate base model; and

B. [redacted] uses a "CF/k-g" model that does not include growth (growth is 0%), whereas the Property Tax Division includes growth at the rate of inflation.

<u>Utah's Fair Market Value Standard And Deferred Federal Income Taxes</u>

[redacted] must be valued at its fair market value. [redacted] Utah law defines fair market value as the following:

> Fair market value means the amount at which property would change hands between a willing buyer and a willing seller neither being under any compulsion to either buy or sell and both having reasonable knowledge of the relevant facts. . . .

Utah Code Ann. § 59-2-102(11)(1999).

Likewise, the Tax Commission has promulgated Rule 16 which requires that [redacted] be valued pursuant to, "fair market value" and that the value "be based upon standard appraisal theory . . ." Rule 16 (1989).

In an effort to comply with these rules, each of the parties has adopted an assumption in support of its interpretation of the fair market value standard of Rule 16.

The Commission believes that the Division's reading of Rule 16, as embodied in its assumption, is more accurate based upon the plain language of Rule 16:

> B. The Tax Commission shall determine the fair market value of the property of each project entity. Fair market value shall be based upon standard appraisal theory and shall be determined by correlating estimates derived from the income and cost approaches to value described below.
>
> 1. The income approach to value requires the imputation of an income stream and a capitalization rate. . . .
>
> 2. The cost approach to value shall consist of the total of the property's net book value of the project's property. This total shall then be adjusted for obsolescence if any.

R884-24P-16 (1989)(emphasis added).

As the plain language of Rule 16 makes clear, the income approach to value requires the imputation of an income stream. However, the plain language of the cost approach requires that the cost approach consist "of the property's net book value." While the language allows for economic obsolescence "if any," the imputation requirement for DFIT is missing. Further, the Division's approach assumes a sale between a buyer and a seller, as required under Utah's fair market value standard. Accordingly, the plain language of Rule 16 more closely supports the Division's approach to value.

Although [redacted] argues that its application of Rule 16 is consistent with the history of that rule, the Commission does not accept [redacted] reading of Rule 16.

The history behind Rule 16 is subject to different interpretations. [redacted] [redacted] testified about the intent behind Rule 16. [redacted] was [redacted] [redacted] at the time Rule 16 was enacted. Despite testimony that [redacted] approach was more consistent with the intent of Rule 16, he testified that it was not anticipated the

Tax Commission would grant a DFIT deduction such as the one proposed by (Tr. 1472, 1485-86.) He said that had "we talked about DFIT in 1984 and 1985, whether it belongs or not, my answer would have been, that's crazy. You don't put it in. It's free money." (Tr. 1490.)

At the Formal Hearing, also stated he was uncertain whether the Commission, when it adopted Rule 16, meant to treat (Tr. 1472.) He testified that he understood (Tr. 1472, 1474-75.) and that it would be a reasonable interpretation of Rule 16 that (Tr. 1475-77.)

further stated that he believed "as we drafted the rule, we were thinking about imputing income and making some – some attempt to measure historical cost less deprecation." (Tr. 1475.)

also testified that the obsolescence adjustment under Rule 16 could be either upward or downward. (Tr. 1477-78.) Factually, agreed there may be no obsolescence if market evidence indicates a value greater than net book value. (Tr. 1478.) He acknowledged there was a question about the existence of obsolescence where properties sell at above book value. (Id.) a witness for the Division, testified (Tr. 1264-1277; Exhibit 78.)

Rule 16 does provide that the cost approach based upon the property's net book value "shall then be adjusted for obsolescence if any". Rule 62 also provides that "DFIT can be one type of economic obsolescence". However, the Commission determines that theoretical DFIT does not constitute actual economic obsolescence. A careful reading of Rule 62 will demonstrate that the reference to DFIT being "one type of economic obsolescence" is limited to rate base regulated utilities. [REDACTED]

[REDACTED] Therefore, theoretical DFIT does not cause any economic obsolescence for the actual property of [REDACTED] and should not be used as a surrogate for economic obsolescence for [REDACTED]

The Commission accepts and adopts the Division's reading of Rule 16 for the following reasons:

1. It more closely follows the plain language of Rule 16.

2. It acknowledges a lien date sale, i.e., it applies the statutory fair market value standard.

3. It acknowledges the full bundle of rights, including the beneficial use of the property

4. It does not require a complex analysis of the effects of contracts or bond agreements because the full bundle of rights is captured within the income approach to value.

5. The cost approach relies on actual historical data as the cost approach has been applied to other taxpayers for the year

The Commission does not accept or adopt interpretation of Rule 16, especially as it relates to DFIT for the following reasons:

1. Numerous witnesses, including testified that this type of methodology would not be employed in the "real world."

2. testified that in a "real world" transaction, he would not advise either the buyer or seller to impute a DFIT adjustment.

3. It would require the Tax Commission to rewrite history to place of obsolescence on the books that does not really exist.

4. does not have an accumulated DFIT balance.

6. There is no evidence linking actual obsolescence to [REDACTED] assumed and theoretical DFIT balance.

8. It is selectively implied.

COST APPROACH

The appraisers for [REDACTED] and the Division have presented similar cost approach models. However, there are differences that need to be addressed by the Tax Commission.

The Commission, above, interpreted Rule 16 to mean there should be no imputation of DFIT in the cost approach. Therefore, a simple cost approach should be used without any DFIT deduction.

Impact Alleviation Payments

made a deduction from his overall value for the depreciation cost of "impact alleviation payments" made during construction to and other governmental entities to build roads, schools, etc. to alleviate the impact (Exhibit 2, pages 36, A, G.)

paid out $ in payments to several different governmental entities.

The Commission rejects deduction of impact alleviation payments as intangible property. originally included them as obsolescence items, but later removed them as intangibles on advice of counsel. (Tr. 271-72.) booked them as part of the capitalized plant. (Tr. 273.) Although argues that these items are prepayments, the manner in which the county accounts for credits eliminates the prepaid property tax nature of these payments. (Tr. 1135-1138.) has failed to meet its burden that impact alleviation payments are capable of private ownership and can be separated from tangible property. Accordingly, they should not be removed from value.

These fees are very similar to licensing fees and impact fees for other developments. The Commission therefore finds that the unrecovered portions of the impact alleviation payments should be included in the cost approach to value.

INCOME APPROACH

Imputed Rate of Return

The Division has in general applied the methodology set forth in Rule 16(B)(1) for: "Imputation of an income stream and a capitalization rate." The method used by the Division to frame the cash flow complies with the preferred methodology for regulated utilities as set forth in Rule 62. This methodology would be reflective of the cash flow of a regulated utility if it were to be purchased on the lien date.

has correctly identified and analyzed these problems. His imputed rate of return makes the corrections necessary to derive an imputed rate of return for

The correct rate of return is 7.4%, as calculated by

Cost of Debt

In determining his Cost of Debt, used actual Aaa bond rating to derive a rate of 7.51%. On the other hand, used the Baa bond rating typical in to determine a cost of debt of 8.20%.

The Commission finds that actual cost of debt is irrelevant to this case because is assumed If actual cost of debt is used in a capitalization rate that is applied to an income stream, there is a mismatch. The elements of the capitalization rate must also be those of an so the typical Baa rate is appropriate.

Accordingly, the Commission finds that the Baa cost of debt of 8.20% used by is appropriate.

Ibbotson Period

used the 70-year Ibbotson period in deriving the risk premium of 7.76% in developing his capital asset pricing model (CAPM), for his cost of equity, consistent with Commission Rule 62. used the same period to derive a risk premium of 7.8%. The Commission has now modified Rule 62 to provide that the "entire historical period contained in the Ibbotson study" will be used.

Cost of Equity

In addition to the Ibbotson CAPM, used a Risk Premium model to which he ascribed 25% weight for his cost of equity. used several cost of equity models. We find application of the CAPM and Risk Premium Models to be consistent with the rule.

Growth

The Commission does have a concern with the growth rate advocated by the Property Tax Division.

In calculating his discount rate, [redacted] included a growth rate of 2.0% based on the inflation rate. (Exhibit 4, page 21 & 25). [redacted] used a growth rate of 0%.

In the current case, the Division advocated that 2.0% was the proper growth rate based on inflation. This position was based on section B.3(a)(3) of Rule 62, where the Commission allows the inflation rate to be used as the growth rate if evidence is insufficient to establish an actual growth rate. (Exhibit 4, page 21.)

The Commission finds that the 2.0% inflation rate is appropriate in this case because the evidence shows that the cash flow of [redacted] from the assets in existence on the lien date will grow over time due to inflation. [redacted] own budgetary forecasts include an inflationary growth component

Size Premium

[redacted] added the Ibbotson size premium of .75% to his calculation of the cost of equity under the Capital Asset Pricing Model.

[redacted] made no size premium adjustment.

In the case of Kern River v. Property Tax Division, Appeal No. 99-0513, the taxpayer advocated the use of a size premium, but the Tax Commission did not adopt it. In a concurring opinion, Commissioner Marc Johnson argued that a size premium was appropriate for Kern River.

The Commission determines that the facts of this case show that [redacted] is sufficiently large that a size premium adjustment to the cost of equity under the Capital Asset Pricing Model is not required or appropriate.

CORRELATION

[redacted] relied on a 70% weighting to his cost indicator of value and a 30% weighting to the income indicator of value. Because the Commission is relying on an imputed income amount and not an actual cash flow, it has less confidence in the income indicator of value. Because the cost approach is based on [redacted] actual books and records, it has greater confidence in that indicator. Accordingly, the Commission therefore determines that less weight should be given to the income indicator of value and more weight should be given to the cost indicator of value. The Commission, therefore, finds that the income approach should be weighted at 30% and the cost indicator should be weighted at 70%.

[redacted] UNIFORMITY ARGUMENT

The Commission holds that [redacted] has not provided sufficient evidence showing that it has been treated differently than similarly situated properties. [redacted] has failed to show that it is similarly situated to any property receiving the type of relief it has requested. In a letter to this Commission dated [redacted] stated that it was similarly situated to not only [redacted] as argued in this proceeding, but also [redacted]

(Letter dated (emphasis added).) Likewise, testified that the tax treatment of is to use a simple cost approach without a DFIT deduction. (Tr. 1560-63.) Accordingly, there is no basis for contention that it should be treated solely like an investor owned utility.

In addition, there are many factors that show that is not similarly situated to

Accordingly, there is no basis for contention that there has been a violation of the Uniformity Clause of the Utah Constitution.

COUNTIES' APPRAISAL

performed a trended original cost for his cost approach. This is a form of reproduction cost. He trended original in service costs from 1986 to 2001 using a broad inflationary index (GDP Product Price Deflator). Reproduction cost is not the cost approach outlined by Rule 16 or preferred by Rule 62. The cost approach outlined by Rule 16 and preferred by Rule 62 is Historical Cost Less Depreciation. The index used by is not specific rather it is a very broad macroeconomic index.

did not perform an income approach. (Appraisal.) Rule 16 requires an income approach to be performed.

Finally, the Commission did not use a sales comparison approach for any other centrally assessed taxpayers in 2001.

VALUE CONCLUSION

Based upon the foregoing analysis, the Commission determines that the fair market value of the property of [redacted] should be calculated as done by [redacted] with the rate of return calculation prepared by [redacted]

DECISION AND ORDER

Based upon the foregoing, the Tax Commission finds that the Utah portion of the fair market value of the subject property as of January 1, 2001 is $[redacted] It is so ordered.

DATED this ______ day of __________________________, 2001.

G. BLAINE DAVIS
Administrative Law Judge

BY ORDER OF THE UTAH STATE TAX COMMISSION.

DATED this ______ day of ________________________, 2001.

____
PAM HENDRICKSON
Commission Chair

____
PALMER DePAULIS
Commissioner

____
MARC B. JOHNSON
Commissioner

NOTICE: You have 20 days after the date of this Order to file a request for reconsideration with the Commission pursuant to Utah Code Ann. § 63-46b-13. A request for reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a request for reconsideration with the Commission, this Order constitutes a final agency action. You have 30 days after the date of this Order to pursue judicial review of this Order in accordance with Utah Code Ann. § 59-1-601 and § 63-46b-13 et seq.