

**Preface and Guidelines for Valuation (Revised)
Submitted to State Board of Equalization April 4, 2006**

PREFACE

The determination of fair cash value for ad valorem tax purposes is a necessary and often complicated, and confusing process. It is important to everyone that fair and equitable values are attained.

The valuation process must remain flexible. The Ad Valorem Division will consider all available and pertinent data while applying currently accepted appraisal techniques to determine an equitable fair cash value for each reporting company.

Valuation is not an exact science. There is neither a single method nor is there a rigid formula that will always provide the proper valuation. It is an involved process using historical and current data, future projections and expectations, and sound appraisal judgment.

The following guidelines are offered as an aid in the valuation of railroad, air carriers and public service corporations. These guidelines provide the starting point in an interactive process that must be supported with good information from the taxpayer and sound judgment from the appraiser.

**GUIDELINES FOR VALUATION
Of
Railroad, Air Carrier and Public Service Property
For
Oklahoma State Board of Equalization**

The Oklahoma Tax Commission, Ad Valorem Division, is charged with the responsibility of valuing all railroad, air carrier and public service corporation property in accordance with Title 68 Oklahoma Statutes, Section 2808.

The term “public service” includes electric companies, fluid or product pipelines, gas distribution and transmission companies, telecommunications, and water companies.

For the valuation of railroad, air carrier and public service property unit valuation is to be employed. This method requires that integrated properties be appraised as a whole or as a unit, as opposed to a summation methodology, which totals the value of each of the component parts. The value created by, and resulting from, the synergistic effect of the combined operations of all the parts as a unit does not exist until the combination is formed.

There are three basic approaches that are generally accepted in determining the “fair cash value” of railroads, air carriers and public service property under the unit valuation concept.

- 1. The Income Approach** – This approach converts projected future income or cash flow into an estimate of present value. This approach is considered by most authorities to be the best for valuing income-generating properties. The Advisory Commission on Intergovernmental Relations in its report, *The Role of the States in Strengthening the Property Tax*, at page 156, states as follows:

Capitalization of earnings is one evidence of value upon which most states making unit assessments rely heavily in valuing practically every utility system. The reason is partially a practical one. Reliable earnings information is available for almost every regulated utility. But more important, the relevancy of capitalized earnings to market value cannot be disputed. ‘The result of the perfect (but impossible) capitalized earnings computation is market value.’ The theory is that a property is worth what it will earn, the problem becomes one of translating anticipated future income into present capital value.

Two major concerns under the income approach to value are: (1) determining the best level of income to use and (2) determining the proper multiple or capitalization rate to apply to the anticipated income stream. The two predominant levels of income utilized are a traditional net operating income and cash flow.

The most widely used system for developing capitalization rates is the Band of Investment Method. Use of this method in the valuation of railroad, air carrier, and public service corporation property produces good and accurate capitalization rates, provided the appraiser uses the market information and does not substitute his or her judgment for the market. The Band of Investment Method is sometimes referred to as the weighted rate because it is derived by weighting the proper common equity rate, preferred equity rate and proper debt rate based on the appropriate capital structure.

For appraisal purposes the typical capital structure of comparable companies shall be used in place of the subject company's actual capital structure. The shares outstanding shall be multiplied by the stock price to derive the equity component for the comparable companies. The debt component shall be based on book amounts unless market amounts are readily available and predetermined to be significantly different.

Only the direct method of developing the equity rate component of the Band of Investment shall be used when capitalizing a single year's income. Equity yield rates in the Band of Investment shall be used only when capitalizing a series of cash flows. In determining a capitalization rate, no adjustment shall be made in either the capitalization rate or the income stream for hypothetical floatation costs. Floatation costs actually incurred may be accounted for in the income stream.

- 2. The Stock and Debt or Market Approach** – In the valuation of railroad, air carrier and public service corporation property this approach comprises a determination of price obtainable from sale of all outstanding capital stock and funded debt. The underlying assumption is that the market value of the securities of a railroad, air carrier and public service corporation is equal to the value of the tangible and intangible assets or property of the company.
- 3. The Cost Approach** – The accepted method for the cost approach is either the original cost or historical cost less depreciation, as carried on the subject company's books. Many railroads, air carriers and public service corporations are regulated by either the federal (SEC, FERC, R1, etc.) or state, (Corporation Commission) government and the depreciation on original cost is set or monitored by such regulating authorities. Recent events have contributed to more oversight by both the public and private sectors resulting in a more reliable indicator than it would be without such oversight.

Once all the value indicators have been calculated, they must be correlated into the appraiser's best estimate of value. In this final correlation of the value indicators, the appraiser must make judgments wherein the professional experience and educational training of the appraiser are called upon to determine the final conclusion of value. Generally, two or more approaches to value contribute in the formulation of the appraiser's judgment, but occasionally only one approach to value is guiding. Correlation is not an exercise in statistical weighting, but rather a serious attempt wherein the appraiser allows his or her experience, knowledge and analysis of economic data to finalize their value judgment.

Allocation is the process of assigning a portion of the correlated unit or system value to a respective state. Allocation should measure the property value as it contributes to the unit and not merely the amount of the physical property in the state. Such allocation should be in fair proportion and include usage and physical situs. The allocation factors developed should total 100% of the system being appraised.

After the fair cash value of the Oklahoma property has been determined, a deduction for Oklahoma exempt property is allowed to arrive at the Oklahoma taxable unit value. Property can only be exempted by provisions of the Oklahoma Constitution, statutes, or by payment of an in-lieu tax, such as gross production tax.

The percentage of fair cash value for real and personal property of railroads, air carriers and public service corporations required by the Oklahoma Constitution to be taxable shall be the percentage at which it was assessed on January 1, 1996, in accordance with the provisions of Article X of the Oklahoma Constitution, and, subject to the requirements of federal law, shall be uniformly applied to calculate the taxable values of public service corporation property within the state for the applicable tax year. The assessment ratios in use January 1, 1996 were 22.85 percent for public service, and 11.84 percent for railroads and air carriers.