

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

3
4 In the Matter of the Petition for)
Reassessment of the 2018 Unitary Value for:)

5
6 **CXA LA PALOMA, LLC (1112)**)

7 Petitioner)

Appeal No.: SAU 18-024

Case ID No.: 1056748

Nonappearance Hearing Date:

December 12, 2018¹

10
11 Representing the Parties:

12 For the Petitioner:

C. Stephen Davis, Attorney
David Grant, Representative

14 For the Respondent:

Sarah J. Garrett, Tax Counsel
Attorney for the State-Assessed Properties Division

Samuel Wang, Principal Property Appraiser
State-Assessed Properties Division

18 Appeals Attorney:

Susan Galbraith, Tax Counsel

19 **VALUES AT ISSUE**

	Value	Penalty	Total
20 2018 Board-adopted Unitary Value	\$58,700,000	\$0	\$58,700,000
21 Petitioner's Requested Unitary Value	\$20,000,000	\$0	\$20,000,000
22 Respondent's Appeal Recommendation	\$58,700,000	\$0	\$58,700,000

23 **Factual Background**

24 Petitioner owns a natural gas-fired, combined-cycle power generation facility in Kern County,
25 California that consists of four generating units. Each unit consists of one gas turbine and one steam
26

27
28 ¹ The Board voted unanimously to deny the petition for reassessment and affirm the 2018 Board-adopted unitary value of \$58,700,000.

1 turbine and has a California Energy Commission (CEC) capacity rating of 1,048 megawatts. The facility
2 commenced commercial operations on March 11, 2003.

3
4 **Legal Issue 1: Whether petitioner has shown that respondent failed to place proper reliance on the**
5 **value indicators in the 2018 Board-adopted unitary value.**

6 **Findings of Fact and Related Contentions**

7 Petitioner asserts that “the Board’s value is based on a 50/50 weighting of the cost and income
8 indicators. Such [weighting] is entirely arbitrary. Merely taking an average of or weighting disparate
9 value indicators is not correct reconciliation. This is especially so where, as here, [] one of the indicators
10 (the cost indicator) is materially overstated.” (Petition, p. 2.)

11 Petitioner requests that respondent place 100 percent reliance on the CEA value indicator,
12 specifically on petitioner’s Discounted Cash Flow (DCF) analysis. (Petition, Exhibit B.) Petitioner’s
13 DCF model capitalizes its 2018 projected income over 10 years, resulting in a \$38,700,000 reduction of
14 petitioner’s 2018 unitary value from the Board-adopted value of \$58,700,000 to \$20,000,000.

15 Respondent states that it calculated the ReplCLD value indicator using a Replacement Cost New
16 (RCN) per megawatt developed by respondent, which it then adjusted for the physical, functional, and
17 economic obsolescence present in the property. The CEA value indicator was calculated using a limited
18 life discounted cash flow (DCF) model based on the remaining economic life of the facility. (SAPD’s
19 Analysis for Appeals Attorney, p.2.)

20 Respondent asserts that the cost approach is the preferred approach when neither sales data nor
21 reliable income data are available (Property Tax Rule 6); that the income approach is used in
22 conjunction with other approaches when the property is purchased in anticipation of a money income
23 and has an established income stream (Rule 8); and that one or more of the approaches to value should
24 be considered as may be appropriate for the property being appraised (Rule 3). Respondent also asserts
25 that the criteria that should be considered when weighting the value indicators to arrive at a final
26 estimate of value are the appropriateness of the approach, the accuracy of the data and adjustments, and
27 the quantity of available evidence. Respondent states that the weighting of the value indicators is
28

1 ultimately based on analysis and judgment and not on a formal quantitative model. (SAPD’s Analysis
2 for Appeals Attorney, p.3.)

3 Moreover, respondent asserts that the sales indicator could not be used since the property recently
4 sold as part of a Chapter 11 bankruptcy proceeding and would not be representative of fair market value.
5 Thus, respondent asserts it relied on the cost and income approaches, consistent with Rules 3, 6, and 8,
6 considering the age of the plant, its earnings history, and the predictability of its future income.
7 Additionally, respondent asserts that over the past several years it has worked with petitioner and other
8 industry participants to refine the cost and income value indicators, and as a result, petitioner’s two
9 value indicators have been numerically converging, which supports the credibility and reliability of each
10 of the value indicators. Furthermore, respondent states that it determined that the ReplCLD and CEA
11 value indicators were equally reliable given the nature of the property and the market conditions and
12 challenges facing the electric generation industry. Respondent states that petitioner’s value is not only
13 reasonable but is the lowest value in terms of value per megawatt when compared to similarly situated
14 combined cycle facilities.
15

16 Finally, respondent contends that petitioner has failed to quantify or provide documentation as
17 to how respondent’s reliance on the cost and income value indicators is arbitrary or inappropriate.
18 Accordingly, respondent recommends that the current weighting of 50 percent reliance on the ReplCLD
19 value indicator and a 50 percent reliance on the CEA value indicator remain unchanged.

20 Applicable Law and Appraisal Principles

21 Burden of Proof

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

26 ReplCLD Value Indicator

27 Property Tax Rule 6, subdivision (a), provides, in part: “The reproduction or replacement cost
28 approach to value . . . is preferred when neither reliable sales data . . . nor reliable income data are

1 available . . .” In general, the ReplCLD valuation methodology is estimated by applying trend factors—
2 price level changes, including the application of “current prices to the labor and material components of
3 a substitute property capable of yielding the same services and amenities, with appropriate additions as
4 specified . . .” (Property Tax Rule 6, subd. (d).) Then, the resulting adjusted cost amount is “reduced by
5 the amount that such cost is estimated to exceed the current value of the reproducible property by
6 reason of physical deterioration, misplacement, over- or underimprovement, and other forms of
7 depreciation or obsolescence. The percentage that the remainder represents of the reproduction or
8 replacement cost is the property’s percent good.” (Property Tax Rule 6, subd. (e).)

9 **Income Approach to Value**

10 Property Tax Rule 8, subdivision (a), states that “the income approach is used in conjunction
11 with other approaches when the property under appraisal is typically purchased in anticipation of a
12 money income and either has an established income stream or can be attributed a real or hypothetical
13 income stream by comparison with other properties.” Subdivision (b) describes the income approach to
14 value as the valuation method whereby, “an appraiser values an income property by computing the
15 present worth of a future income stream. This present worth depends upon the size, shape, and duration
16 of the estimated stream and upon the capitalization rate at which future income is discounted to its
17 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a
18 reasonably well-informed owner and reasonably well informed buyers may anticipate on the valuation
19 date that the taxable property existing on that date will yield under prudent management and subject to
20 legally enforceable restrictions as such persons may foresee as of that date.”

21 **Reconciliation of Value Indicators**

22 Property Tax Rule 3 requires that, in estimating value, the assessor shall consider one or more
23 of the approaches to value “as may be appropriate for the property being appraised,” which includes the
24 comparative sales approach, the replacement or reproduction cost approach (e.g., ReplCLD valuation
25 methodology), or the income approach. The appropriateness of an approach is often related to the type
26 of property being appraised and the available data. (Assessors’ Handbook section 502, *Advanced*
27 *Appraisal* (December 1998) (AH 502), p. 109.) In addition, the validity of a value indicator will depend
28 upon the accuracy of data and adjustments made to the approach. That is, the accuracy of a value

1 indicator depends on the amount of available comparable data, the number and type of adjustments, and
2 the dollar amount of adjustments. Finally, if a large amount of comparable data is available for a given
3 approach, the appraiser may have more confidence in that approach. For example, if income, expense,
4 and capitalization rate data can be obtained from many properties comparable to the subject, the
5 appraiser may attribute significant accuracy to the income approach. The greatest reliance should be
6 placed on that approach or combination of approaches that best measures the type of benefits the
7 subject property yields. The final value estimate reflects the relative weight that the appraiser assigned,
8 either implicitly or explicitly, to each approach. (AH 502, p. 112.)

9 Analysis and Disposition

10 Respondent is presumed to have correctly determined the value of the property at issue, and
11 petitioner bears the burden of proving otherwise. Here, petitioner contends that respondent should place
12 zero percent reliance on the ReplCLD value indicator because any weighting of the cost approach is
13 entirely arbitrary, and instead should place 100 percent reliance on the CEA value indicator as
14 submitted in petitioner's DCF model. However, respondent states its weighting follows Rules 3, 6, and
15 8, Assessors' Handbooks, and other Board guidelines, and that the weighting of the value indicators is
16 ultimately based on an appraiser's analysis and judgment. Respondent determined that the ReplCLD
17 and CEA value indicators were equally reliable given the nature of the property and the market
18 conditions and challenges facing the electric generation industry. Because petitioner has not provided
19 an analysis or any documentation showing how respondent's equal reliance on the cost and income
20 value indicators is arbitrary or inappropriate, the Appeals Attorney finds that the petitioner has not met
21 its burden of proving that respondent's determination to place 50 percent reliance on the ReplCLD
22 indicator and 50 percent reliance on the CEA indicator was in error, and recommends that no adjustment
23 be made for this issue.

24
25 **Legal Issue 2: Whether petitioner has shown that respondent improperly included soft costs in the**
26 **assessed value of the land in its ReplCLD value indicator.**
27
28

Findings of Fact and Related Contentions

Petitioner contends that respondent relied on external and internal studies to arrive at \$854,000 per megawatt replacement cost new (RCN) for power plant improvements, which was used to establish the improvement value. Petitioner also asserts that respondent added an additional \$10,400 per megawatt in soft costs to the land value, but that the soft costs were already included in the \$854,000 per megawatt cost used to arrive at the RCN. In addition, petitioner states that by adding the total soft costs of \$10,899,200 to the land value, respondent avoids depreciating the assets and double assesses the taxpayer as to this amount. Petitioner asserts that the soft costs allocated to the land of \$10,400 per megawatt are identified as “full economic costs” in Assessors’ Handbook Section 502, *Advanced Appraisal* (p. 13), which should be included in the improvement value. Moreover, petitioner states that adding soft costs to the land value rather than the improvement value deprives the taxpayer of depreciation on the costs since respondent does not depreciate the land portion of the valuation. Finally, petitioner asserts that deducting \$10,899,200 in soft costs from the cost indicator results in an overall ReplCLD value indicator of \$54,906,778, or \$27,453,389 after a 50 percent weighting. (Petition, p. 2.)

Respondent states that Rule 6 provides that the ReplCLD value of property may be estimated by applying current prices to the property’s labor and material components, with appropriate additions for costs incurred in bringing the property to a finished state. Respondent also asserts that soft costs, or indirect costs, are generally thought of as expenditures for items other than labor and materials incurred in bringing the property to a finished state.² Additionally, respondent asserts that for real property, improvement cost is the total cost of development of the improvements added to a site, *exclusive of the cost of items classified as land*. (SAPD Analysis for Appeals Attorney, p. 5, citing AH 501, p. 74.)

Applicable Law and Appraisal Principles

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Therefore, petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT World*

² In this context, respondent states that land soft costs refer to excavation, grading, clearing, stabilizing, compacting or other processes affecting the land component of the facility that are not otherwise captured by direct improvement costs.

1 *Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18, § 5541,
2 subd. (a).)

3 ReplCLD Value Indicator

4 Property Tax Rule 6, subdivision (a), provides, in part: “The reproduction or replacement cost
5 approach to value . . . is preferred when neither reliable sales data . . . nor reliable income data are
6 available . . .” In general, the ReplCLD valuation methodology is estimated by applying trend factors—
7 price level changes, including the application of “current prices to the labor and material components of
8 a substitute property capable of yielding the same services and amenities, with appropriate additions as
9 specified . . .” (Property Tax Rule 6, subd. (d).) Then, the resulting adjusted cost amount is “reduced by
10 the amount that such cost is estimated to exceed the current value of the reproducible property by
11 reason of physical deterioration, misplacement, over- or underimprovement, and other forms of
12 depreciation or obsolescence. The percentage that the remainder represents of the reproduction or
13 replacement cost is the property’s percent good.” (Property Tax Rule 6, subd. (e).)

14 Analysis and Disposition

15 Respondent is presumed to have correctly determined the value of the property at issue, and
16 petitioner bears the burden of proving otherwise. Here, petitioner contends that respondent included in
17 its land value an additional \$10,400 per megawatt in soft costs, but that the soft costs were already
18 included in the \$854,000 per megawatt cost used to arrive at the RCN. Respondent states that indirect
19 land costs (excavation, grading, cleaning, stabilizing, compacting, etc.) are taxable costs attributable to
20 land development, add considerable value to raw land, and must be added to land value under Rule 6.
21 Respondent asserts that land costs were not double counted in petitioner’s 2018 unitary value. Because
22 petitioner has not shown any evidence of soft costs that were double counted, the Appeals Attorney finds
23 that the petitioner has not met its burden of proving that respondent improperly included soft costs in the
24 assessed value of land in its ReplCLD value indicator and recommends no adjustment for this issue.

25
26 **Legal Issue 3: Whether petitioner has shown that respondent failed to adequately measure**
27 **obsolescence in the ReplCLD value indicator.**
28

Findings of Fact and Related Contentions

Petitioner asserts that respondent's own rules require that the replacement cost be adjusted for all forms of depreciation, and cites Rule 6, subdivision (e) requiring that the RCN be reduced by the amount the costs exceed the current value of the property due to under or over improvement and other forms of depreciation or obsolescence. Petitioner states that no adjustment was made to its cost indicator for excess capacity (over improvement) or economic obsolescence as required by Rule 6. Additionally, petitioner asserts that when there is a material difference between the income indicator and cost indicator, there is strong evidence of obsolescence, and that the cost indicator should be reduced by the difference between the RCN and the income indicator when such a material difference exists. Petitioner further asserts that the cost indicator is more than double an appropriate income indicator. Thus, petitioner argues that respondent should have reduced its cost indicator by an additional \$45,038,123 using the income shortfall method, such that the actual cost indicator should be \$20,768,000 rather than \$65,805,978 as calculated by respondent. (Petition, p. 3.)

Respondent asserts that petitioner, while failing to identify additional obsolescence that has not been recognized, appears to suggest that the cost approach must be adjusted to the CEA value indicator or not considered at all. Respondent asserts that this is not an acceptable methodology for measuring obsolescence, and that petitioner's contentions do not provide evidence to justify additional adjustments to the ReplCLD value indicator. (SAPD's Analysis for the Appeals Attorney, p. 6.) Respondent contends that the ReplCLD value indicator reflects all forms of obsolescence including adjustments for depreciation (\$447.5 million), underutilization (\$238.2 million), diminished spark spread³ (\$120.7 million), heat rate adjustment (\$10.23 million), and excess operating costs (\$26.6 million). In total, respondent states that it has recognized approximately \$843,000,000, or 94 percent of the replacement cost new of the plant as obsolescence from all sources (physical, functional and economic) based on verifiable data. Moreover, although petitioner asserts that additional obsolescence exists, respondent states that petitioner did not provide any calculations or supporting evidence to quantify additional obsolescence not already reflected in respondent's ReplCLD approach. Finally, respondent argues that it has reviewed

³ Spark spread is the difference between the price received for electricity and the cost of the gas needed to produce the electricity.

1 values adopted by the Board on a per megawatt basis for similar facilities and determined that petitioner's
2 2018 Board-adopted value is reasonable, and in fact, has the lowest value in terms of value per megawatt
3 of the facilities reviewed. (SAPD's Analysis for the Appeals Attorney, p. 7.) Therefore, respondent
4 recommends no further adjustments be made to the ReplCLD value indicator.

5 Applicable Law and Appraisal Principles

6 Burden of Proof

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

11 ReplCLD Value Indicator

12 Property Tax Rule 6, subdivision (a), provides, in part: "The reproduction or replacement cost
13 approach to value . . . is preferred when neither reliable sales data . . . nor reliable income data are
14 available . . ." In general, the ReplCLD valuation methodology is estimated by applying trend factors—
15 price level changes, including the application of "current prices to the labor and material components of
16 a substitute property capable of yielding the same services and amenities, with appropriate additions as
17 specified . . ." (Property Tax Rule 6, subd. (d).) Then, the resulting adjusted cost amount is "reduced
18 by the amount that such cost is estimated to exceed the current value of the reproducible property by
19 reason of physical deterioration, misplacement, over- or underimprovement, and other forms of
20 depreciation or obsolescence. The percentage that the remainder represents of the reproduction or
21 replacement cost is the property's percent good." (Property Tax Rule 6, subd. (e).)

22 Depreciation and the Replacement Cost Approach

23 In general, the ReplCLD value indicator recognizes three types of depreciation: physical
24 deterioration, functional obsolescence, and external, or economic, obsolescence, through the application
25 of the Board's replacement cost new trend factors and "percent" good factors. Obsolescence may occur
26 when property is outmoded (functional obsolescence) or when some event has substantially diminished
27 the future earning power of the property (economic obsolescence). (*See* Assessors' Handbook section
28 501, *Basic Appraisal* (January 2002), pp. 81-83.) Functional obsolescence is the loss of value in a

1 property caused by the property's loss of capacity to perform the function for which it was intended.
2 (*Id.* at p. 81.) Economic obsolescence is the diminished utility of a property due to adverse factors
3 external to the property being appraised and is incurable by the property owner. (*Id.* at p. 82.)
4 Petitioner has the burden of establishing the existence of any additional or extraordinary obsolescence.
5 (*See* Property Tax Rule 6, subs. (d) & (e); Cal. Bd. of Equalization, Assessors' Handbook § 502,
6 *Advanced Appraisal* (December 1998) (AH 502), pp. 20-21; UVM, p. 30.)

7 **Analysis and Disposition**

8 Respondent is presumed to have correctly determined the value of the property at issue, and
9 petitioner bears the burden of proving otherwise. Here, respondent calculated a total of approximately
10 \$843,000,000 in adjustments for obsolescence, or 94 percent of the replacement cost new of the plant,
11 which petitioner contends does not adequately account for all obsolescence. In support of its position
12 for an additional obsolescence adjustment, petitioner argues that when there is a material difference
13 between the income indicator and cost indicator, as in the present case, the cost indicator should be
14 reduced by the difference between the cost and income indicators. Petitioner states that the cost indicator
15 is more than double an appropriate income indicator, and therefore respondent should have reduced its
16 cost indicator to \$20,768,000 using the income shortfall method to arrive at that value. Because petitioner
17 does not provide evidence to support its claim that additional obsolescence exists, the Appeals Attorney
18 finds that petitioner has not met its burden of proving that the 2018 Board-adopted unitary value failed
19 to adequately account for depreciation and obsolescence in the RepICLD value indicator and does not
20 recommend any further adjustments for obsolescence.

21
22 **Legal Issue 4: Whether petitioner has shown that the RepICLD value indicator may not be**
23 **appropriately relied upon due to the degree of obsolescence present.**

24 **Findings of Fact and Related Contentions**

25 Petitioner contends that the cost approach was unreliable on the lien date given the substantial
26 obsolescence present (94 percent). Petitioner asserts that the income approach is the preferred approach
27 when reliable sales data is not available and the cost approach is unreliable because the property has
28 suffered considerable physical depreciation, functional or economic obsolescence, or is a substantial

1 over improvement or under improvement, pursuant to Rule 8, subdivision (a). Therefore, petitioner
2 argues that the income indicator is the most suitable method to determine the assessed value of its
3 power plant. (Petition, p. 3.)

4 Respondent asserts that all adjustments it made in calculating the ReplCLD value indicator were
5 in accordance with generally-accepted appraisal methodology and are consistent with Board published
6 references, including AH 502, *supra*, p. 112 (stating that the weighting of value indicators is ultimately
7 to be determined by analysis and judgment rather than a formal quantitative model) and the *Guidelines*
8 *for Substantiating Additional Obsolescence for State-Assessed Property*. (SAPD Analysis for Appeals
9 Attorney, p. 8.) Respondent also states that the obsolescence adjustments to petitioner's ReplCLD value
10 indicator are supported by verifiable data submitted by petitioner. Additionally, respondent asserts that,
11 in its judgment and as required by Rules 3, 6, and 8, it is appropriate to weight the ReplCLD and CEA
12 value indicators equally given the available data, the nature of the electric generation industry, and
13 issues that are specific to petitioner. Respondent asserts that Rule 8, subdivision (a) requires that the
14 income approach be used *in conjunction with other approaches when the property has an established*
15 *income stream or can be attributed a real or hypothetical income stream*. (SAPD Analysis for Appeals
16 Attorney, p. 8.) Respondent further contends that, while petitioner has an established income stream or
17 can be attributed an income stream, petitioner's income stream is not sufficiently established or
18 sufficiently reliable to increase the weighting of the CEA approach or to eliminate reliance on the
19 ReplCLD approach completely. Respondent states that petitioner has not provided documentation to
20 prove otherwise.

21 Furthermore, respondent asserts that petitioner's ReplCLD value indicator has decreased
22 significantly over the past five lien dates, and that the ReplCLD and CEA value indicators have been
23 converging, lending support to the reliability of the ReplCLD value indicator and to respondent's equal
24 reliance on the indicators. Respondent states that both indicators are based on a thorough analysis of
25 financial data provided by petitioner and full consideration of the market conditions and challenges
26 facing the electric generation industry. Finally, respondent states that petitioner must prove the income
27 indicator is more reliable than the ReplCLD indicator before greater reliance can be placed on the
28 income indicator, and petitioner has not done so. Nor has petitioner provided documentation showing

1 that respondent’s reliance on the ReplCLD indicator is inappropriate. For these reasons, respondent
2 recommends no adjustments be made for this issue.

3 Applicable Law and Appraisal Principles

4 Burden of Proof

5 Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)
6 Therefore, the petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT*
7 *World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18,
8 § 5080 subd. (a).)

9 ReplCLD Value Indicator

10 Property Tax Rule 6, subdivision (a), provides, in part: “The reproduction or replacement cost
11 approach to value . . . is preferred when neither reliable sales data . . . nor reliable income data are
12 available . . .” In general, the ReplCLD valuation methodology is estimated by applying trend factors—
13 price level changes, including the application of “current prices to the labor and material components of
14 a substitute property capable of yielding the same services and amenities, with appropriate additions as
15 specified . . .” (Property Tax Rule 6, subd. (d).) Then, the resulting adjusted cost amount is “reduced by
16 the amount that such cost is estimated to exceed the current value of the reproducible property by
17 reason of physical deterioration, misplacement, over- or underimprovement, and other forms of
18 depreciation or obsolescence. The percentage that the remainder represents of the reproduction or
19 replacement cost is the property’s percent good.” (Property Tax Rule 6, subd. (e).)

20 Property Tax Rule 8, subdivision (a), states that “the income approach is used in conjunction
21 with other approaches when the property under appraisal is typically purchased in anticipation of a
22 money income and either has an established income stream or can be attributed a real or hypothetical
23 income stream by comparison with other properties.” Subdivision (b) describes the income approach to
24 value as the valuation method whereby, “an appraiser values an income property by computing the
25 present worth of a future income stream. This present worth depends upon the size, shape, and duration
26 of the estimated stream and upon the capitalization rate at which future income is discounted to its
27 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a
28 reasonably well-informed owner and reasonably well informed buyers may anticipate on the valuation

1 date that the taxable property existing on that date will yield under prudent management and subject to
2 legally enforceable restrictions as such persons may foresee as of that date.”

3 **Income Approach to Value**

4 Property Tax Rule 8, subdivision (a), states that “the income approach is used in conjunction
5 with other approaches when the property under appraisal is typically purchased in anticipation of a
6 money income and either has an established income stream or can be attributed a real or hypothetical
7 income stream by comparison with other properties.” Subdivision (b) describes the income approach to
8 value as the valuation method whereby, “an appraiser values an income property by computing the
9 present worth of a future income stream. This present worth depends upon the size, shape, and duration
10 of the estimated stream and upon the capitalization rate at which future income is discounted to its
11 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a
12 reasonably well-informed owner and reasonably well informed buyers may anticipate on the valuation
13 date that the taxable property existing on that date will yield under prudent management and subject to
14 legally enforceable restrictions as such persons may foresee as of that date.”

15 **Reconciliation of Value Indicators**

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

1 subject property yields. The final value estimate reflects the relative weight that the appraiser assigned,
2 either implicitly or explicitly, to each approach. (AH 502, p. 112.)

3 Analysis and Disposition

4 Respondent is presumed to have correctly determined the value of the property at issue, and
5 petitioner bears the burden of proving otherwise. Here, petitioner states that the income approach
6 should be relied upon since the cost approach is unreliable due to the substantial obsolescence present
7 in petitioner's property on the lien date. Respondent states that it is appropriate to weight the cost and
8 income indicators equally considering the available data, the nature of the electric generation industry,
9 and Rules 3, 6, and 8. Specifically, respondent asserts that Rule 8, subdivision (a) requires that the
10 income approach be used in conjunction with other approaches when the property has an established
11 income stream or can be attributed a real or hypothetical income stream. Because petitioner has not
12 provided documentation showing that the CEA value indicator is more reliable than the ReplCLD value
13 indicator or that greater weight should be placed on the CEA value indicator, and has not provided
14 documentation proving that respondent's reliance on the ReplCLD indicator is inappropriate, the
15 Appeals Attorney finds that the petitioner has not met its burden of proving that the ReplCLD value
16 indicator may not be appropriately relied upon to determine petitioner's 2018 Board-adopted unitary
17 value and recommends no further adjustments be made as to this issue.

18
19 **Legal Issue 5: Whether petitioner has shown that respondent failed to properly calculate the**
20 **CEA Value Indicator.**

21 Findings of Fact and Related Contentions

22 Petitioner states that the CEA value indicator is used when property under appraisal is purchased
23 in anticipation of a money income and either has an established income stream or an income stream that
24 can reasonably be imputed to the property. Petitioner also asserts that "The Board's staff utilized
25 reported revenue and expenses given to them by Petitioner for 2018 only...[and] added this projection to
26 the previous 3-years income and used an average of the 4 years to 'stabilize' income at \$9,632,050 for
27 10 years even though the projected income for 2018 is only \$3,226,109. The BOE Staff's 2018 CEA
28 value indicator for [petitioner] is \$51,632,799. Staff is imputing 'phantom' revenue to [petitioner] for

1 assessment purposes without demonstrating any basis to support the implicit assumption that a well-
2 informed, prudent buyer would do so.” (Petition, p. 4.)

3 Additionally, petitioner states that respondent is “capitalizing revenue from hypothetical non-
4 existent above-market and out-of-market contracts, which contracts are exempt intangible assets. Hence,
5 [respondent’s] income approach includes the value of intangible assets for which specific income
6 streams can be identified in violation of *Elk Hills Power, LLC v. State Board of Equalization*. (*Elk*
7 *Hills*.) (Petition, p. 4.) Finally, petitioner argues that the facility began operations in 2003, has a
8 predictable income stream as shown in reports provided to respondent with petitioner’s annual property
9 statement, and that the appropriate CEA value indicator using petitioner’s projected 2018 revenue only
10 indicates a value of \$19,962,828. (Petition, p. 8.)

11 Respondent states that while the CEA value indicator is normally calculated from projected revenues,
12 fuel costs, and operating expenses provided by petitioner, respondent’s CEA value indicator is
13 calculated using an average of petitioner’s three most recent years of actual operating income along with
14 one year of petitioner’s projected operating income for calendar year 2018.

15 Respondent contends that calculating the CEA indicator based solely on petitioner’s projected
16 revenues decreases the reliability of the CEA value for several reasons. First, respondent asserts that
17 although petitioner claims it has a predictable income stream, the actual records show that it has had
18 significant discrepancies between annually reported income projections and actual Net Operating
19 Income (NOI), and that the average discrepancy rate between petitioner’s actual NOI and its projected
20 earnings for the past four years exceeds 100 percent. For example, in 2017, respondent states that
21 petitioner’s predecessor forecasted losses of \$14.2 million but in fact generated a positive 2017 NOI of
22 \$22.4 million. Second, respondent states that while petitioner provided a one year (2018) income
23 forecast on Schedule H of its property statement, petitioner has not provided its 2018 actual operating
24 income to date to allow respondent to verify whether such data supports or disputes petitioner’s
25 projections. Third, respondent argues that, like most state-assessed electric generation facilities,
26 petitioner operates without long term purchase power agreements, which means its income projections
27 are less reliable since revenue is generated by selling power on a day to day basis. Respondent asserts
28 that, for these reasons, using a four year income average that relies on actual income in its DCF is more

1 reliable and realistic than relying on petitioner’s one year forecast projected over its 10 year remaining
2 economic life. (SAPD’s Analysis for Appeals Attorney, p. 9-10.)

3 Moreover, respondent states that petitioner has not provided any documentation to support its
4 claim that respondent’s CEA value indicator reflects “out-of- market” or “favorable contract” revenues
5 that violate *Elk Hills*. Finally, respondent asserts that petitioner has not provided any documentation to
6 support its view that respondent’s CEA value indicator is flawed and petitioner’s CEA value is more
7 reliable. For these reasons, respondent asserts that its reliance on a four year average of historical
8 income in the CEA approach is more reliable and realistic than a one year forecast, and recommends no
9 further adjustments to the CEA value indicator.

10 Applicable Law and Appraisal Principles

11 Burden of Proof

12 Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.)
13 Therefore, the petitioner has the burden of showing that the assessment is incorrect or illegal. (*ITT*
14 *World Communications v. Santa Clara* (1980) 101 Cal.App.3d 246; see also Cal. Code Regs., tit. 18,
15 § 5080 subd. (a).)

16 Income Approach to Value

17 Property Tax Rule 8, subdivision (a), states that “the income approach is used in conjunction
18 with other approaches when the property under appraisal is typically purchased in anticipation of a
19 money income and either has an established income stream or can be attributed a real or hypothetical
20 income stream by comparison with other properties.” Subdivision (b) describes the income approach to
21 value as the valuation method whereby, “an appraiser values an income property by computing the
22 present worth of a future income stream. This present worth depends upon the size, shape, and duration
23 of the estimated stream and upon the capitalization rate at which future income is discounted to its
24 present worth.” Subdivision (c) provides that “the amount to be capitalized is the net return which a
25 reasonably well-informed owner and reasonably well informed buyers may anticipate on the valuation
26 date that the taxable property existing on that date will yield under prudent management and subject to
27 legally enforceable restrictions as such persons may foresee as of that date.”
28

Analysis and Disposition

Respondent is presumed to have correctly determined the value of the property at issue, and petitioner bears the burden of proving otherwise. Here, petitioner calculated its CEA value indicator using a DCF model with a 10 year remaining economic life and petitioner's projected income for 2018. Respondent's CEA value indicator was calculated using an average of petitioner's three most recent years of actual operating income and one year of petitioner's projected operating income for 2018, stating that its reliance on a four year income average that uses actual income in its DCF is more reliable than petitioner's one year forecast projected over 10 years. Because petitioner has not presented any documentation or evidence to show how respondent's calculation of the CEA value indicator was in error, the Appeals Attorney concludes that petitioner has not meet its burden of proving that respondent failed to properly calculate petitioner's CEA value indicator and recommends no adjustment be made for this issue.

Decision

Accordingly, the petition for reassessment is denied and the 2018 Board-adopted unitary value of \$58,700,000 is affirmed.*

George Runner _____, Chairman

Diane L. Harkey _____, Member

Jerome Horton _____, Member

* The decision was rendered in Sacramento, California on December 12, 2018. This summary decision document was approved on February 26, 2019, in Sacramento, California.

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