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TO COUNTY ASSESSORS AND INTERESTED PARTIES:

GUIDELINES FOR THE ASSESSMENT OF
BILLBOARD PROPERTIES

On November 13, 2002, the Board of Equalization adopted the enclosed guidelines pertaining to the assessment of billboard properties.

Board staff drafted these guidelines in consultation with interested parties and, after discussions, two unresolved issues remained for Board decision. Those issues were:

(1) Whether in applying the income approach to value, operating income may be used in estimating the income to be capitalized.

(2) Determination of language regarding the treatment of special use permits necessary to site a billboard improvement.

The Board decided that (1) the use of operating income is disfavored because of the difficulty in isolating the income attributable to the taxable property, and (2) since a billboard use permit is necessary to put the land to beneficial and productive use as a billboard site, the land must be assessed and valued by assuming the presence of the use permit.

We hope this information proves useful and promotes uniformity of assessment for these properties. If you have any questions, please contact our Real Property Technical Services Unit at (916) 445-4982.

Sincerely,

/s/ David J. Gau

David J. Gau
Deputy Director
Property and Special Taxes Department

DJG:sk
Enclosure

ASSESSMENT OF BILLBOARD PROPERTIES

DESCRIPTION OF BILLBOARDS

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

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

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

A billboard is essentially a frame supported by a pole (or poles), to which a display panel is attached on one or both sides. Sometimes a billboard is mounted to a building or other structure rather than being free standing. Almost all newly constructed billboards are made of steel and are designed to modern engineering standards. They are structurally secured to the land on a permanent foundation.

Billboards come in four standard configurations: "juniors" (standard panel size 6 x 12 feet); "posters" (standard panel size 12 x 25 feet); "bulletins" (standard panel size 14 x 48 feet, sometimes slightly smaller); and "spectaculars" (billboards built to order, with unique shapes and features, typically as large or larger than bulletins).

The billboard site—that is, the land on which the billboard is situated—is generally limited to an area large enough to accommodate the billboard's foundation and to allow for service and maintenance of the billboard. As noted above, the billboard owner generally holds a leasehold interest in the billboard site; fee simple ownership in the billboard site is usually held by an unrelated party that owns the land contiguous to the billboard site.

CLASSIFICATION OF BILLBOARDS

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

BILLBOARD PROPERTY COMPONENTS AND APPRAISAL UNIT

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

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

APPROACHES TO VALUE

Where the entire billboard property is subject to reassessment, then any of the three generally accepted approaches to value may be used.[2] Discussed briefly below are the cost approach, the comparative sales approach (using a gross income multiplier, or "GIM"), and the income approach, using direct capitalization with a sales-derived overall capitalization rate.[3]

However, as a practical matter, the appraiser will in most cases be valuing the billboard improvement in isolation using the cost approach. The land (i.e., the leasehold interest in the billboard site) would generally be subject to reassessment only upon a transfer of the lessor's interest. Thus, in most cases the appraiser will have no need to request either income data from the billboard operator or lease data from the landowner in order to develop an indicator of value under either the income or comparative sales approaches.

COST APPROACH

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

1. Estimate the cost new of constructing and siting the billboard improvement.

[1] See Revenue and Taxation Code section 51, subdivision (e); Property Tax Rule 324; and Assessors' Handbook Section 502 (AH 502), *Advanced Appraisal*, (December 1998), pp. 2-5.

[2] For additional information concerning the approaches to value generally, see Assessors' Handbook Section 501, *Basic Appraisal,* AH 502, or a general appraisal text. As provided in Property Tax Rules 4, 6 and 8, one approach to value may be preferred over other approaches if reliable data necessary for applying the other approaches to value is not available or when certain factors make the other approaches less reliable.

[3] Where the entire billboard property is subject to reassessment, assessors may rely upon the same authorities for gathering relevant assessment data about billboard properties as are relied upon for other types of property. Such authorities include the general requirement, under section 441 of the Revenue and Taxation Code, that persons make available to the assessor information or records regarding his or her property. With respect to billboard properties, the assessor may request a timely filed property statement (Form BOE-571-L) showing all taxable billboard property, including its location and description, that is owned, claimed, possessed, controlled, or managed by the company.

2. Estimate the depreciation incurred by the billboard improvement.[4]

3. Subtract the estimated depreciation from the cost new to arrive at the depreciated cost of the billboard improvement.

4. Estimate the value of the leasehold interest in the billboard site held by the billboard company.

5. Add the value of the leasehold interest in the billboard site to the cost new less depreciation of the billboard improvement to arrive at a value indicator for the billboard property.[5]

The estimated cost new should reflect the full economic cost of creating the substitute billboard improvement, comprising direct ("hard") costs, indirect ("soft") costs, and entrepreneurial profit.[6] Cost data may be obtained from property statements filed by billboard companies or from contractors who construct billboard improvements.

In all approaches, the value of intangible assets and rights must be excluded from the final value indicator for the taxable property. In general, this adjustment is unnecessary in the cost approach because in that approach intangible assets and rights typically are not included as components of the appraisal unit.[7]

COMPARATIVE SALES APPROACH—GROSS INCOME MULTIPLIER

In direct sales comparison, a value indicator is developed by comparing a comparable property to the subject property and adjusting the sale price of the comparable property for differences between it and the subject.[8] Billboard properties, however, typically sell in groups, and there is little data regarding sales of individual billboard properties. This makes it difficult to apply direct sales comparison to billboard properties.

Since sales of individual billboard properties rarely occur, it may be more practicable to use a gross income multiplier (GIM) derived from a sale of a group of billboard properties. The GIM method is commonly used within the billboard industry as a means of evaluating purchases and sales of billboard properties.

In some instances, it may be possible to develop a GIM from a sale by dividing the sale price by the annual gross advertising income which a group of billboard properties generate. Using GIMs

[4] As with other improvements, billboards are subject to three forms of depreciation, or loss in value: physical deterioration, functional obsolescence, and external obsolescence. In typical practice, the depreciation of a billboard improvement is estimated using age-life depreciation, or percent-good tables. Assessors' Handbook Section 581 (AH 581), *Equipment Index and Percent Good Factors*, contains tables of index and percent good factors for various types of fixtures. It is recommended that Table 1 ("Commercial Equipment Index Factors") and Table 4 ("Machinery and Equipment Percent Good Factors") from AH 581 be used to estimate cost new less normal depreciation.

[5] Steps 4 and 5 are necessary only when the land has undergone a change in ownership pursuant to the provisions of subdivision (c)(1) of Revenue and Taxation Code section 61, and Property Tax Rule 462.100, subsections (a)(1) and (a)(2).

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

[7] AH 502, p. 159, fn. 126.

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

in the assessment of a billboard property, however, will produce excessive taxable values unless significant, and sometimes subjective, adjustments are made.[9] This occurs because GIMs are derived from the total advertising income generated by a group of assets which are often found in multiple counties, including non-billboard property and non-taxable assets (such as intangible billboard use permits). In addition, the advertising income generated by a group of billboard properties will usually include non-assessable "synergy" value which results from operating a group of billboards.

Gross income multipliers should be used only when the reported sale is very similar to the subject billboard property, and the reported sale must be adjusted in order to make it closely comparable to the subject billboard property in terms of income potential, expense ratios, location and physical characteristics.[10]

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

- Convert any noncash consideration accepted by the seller as all or part of the purchase price to its cash equivalent amount.
- Remove the estimated value of any real property included in the sale that is not part of the billboard plant (i.e., billboard properties) from the reported sale price (e.g., an office building or shop/maintenance facility).
- Remove the estimated value of any personal property included in the sale from the reported sale price (e.g., equipment, furnishings, automobiles).
- Remove the estimated value of any intangible assets or rights (i.e., use permit value and enterprise value) included in the sale from the reported sale price.

INCOME APPROACH—DIRECT CAPITALIZATION

In the income approach, rental income is preferred to operating income, since operating income may be attributable, in part, to nontaxable property or other sources. There are several types of income associated with billboard properties, including income from the lease of a billboard improvement to a billboard operator (this rarely occurs). Billboard advertising income is equivalent to operating income and should not be used.[11]

Once the anticipated future income is estimated, appropriate deductions for vacancy and collection loss, commissions to advertising agencies, and operating expenses are made to arrive at net income. Operating expenses include painting and production (poster installation), maintenance, electricity, management, insurance, and recurring permit fees (not use permit fees).

[9] AH 502, p. 160.
[10] AH 502, p. 81; Property Tax Rule 8, subsection (h).
[11] Property Tax Rule 8, subsection (e). Although income attributable solely to taxable billboard property might be imputed by excluding income related to nontaxable operating assets, this technique is disfavored because of the difficulty in making the deductions necessary to identify the discrete income stream for the taxable property only. AH 502, pp. 162, 164.

After net income is determined, an appropriate capitalization rate must be developed. An overall capitalization rate can be derived from a sale of a comparable billboard property (or group of comparable billboard properties). The rate is then applied to the subject billboard property (or group of billboard properties) to generate the value indicator.

INTANGIBLE ASSETS AND RIGHTS

The siting, construction, and operation of billboard properties is regulated by the Outdoor Advertising Act and/or by county or municipal ordinances.[12] The Outdoor Advertising Act or these local laws (or both in some instances) control the issuance of billboard use permits. State and local governments have used these laws to limit the number of billboards in many areas. By regulating (i.e., limiting) the number of billboard use permits, government has increased the value of existing billboard properties. The value resulting from the scarcity of billboard use permits should be attributed to the use permits and not to the billboard improvements.

The billboard use permit is an intangible asset or right under Revenue and Taxation Code section 110(e) that is necessary for the beneficial and productive use of the billboard property. Since the use permit is an intangible asset or right that is not itself assessable, any increment of value attributable to the use permit must not be included in the taxable value of the billboard property.[13] However, since a billboard use permit is necessary to put the land to beneficial and productive use as a billboard site, the land must be assessed and valued by assuming the presence of the use permit.[14]

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

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

ALLOCATION OF VALUE TO BILLBOARD PROPERTY COMPONENTS

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

[12] In regard to the Outdoor Advertising Act, see Business and Professions Code section 5200, et seq.
[13] AH 502, pp. 152, 163.
[14] See Revenue and Taxation Code section 110, subdivision (e); AH 502, pp. 154-155.

1. Estimate the value of the billboard property net of the value of non-taxable intangible assets and rights, including the value of the billboard use permit. This establishes the taxable value that is to be allocated.

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

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

The portion of the value of the billboard property that is allocated to the land may or may not be assessable depending on the terms of the ground lease. In order to reassess the value allocated to land, a change in ownership of the land under article XIII A ("Proposition 13") must have occurred.[15]

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

the billboard site. (And as noted, any value attributable to the billboard company's leasehold interest in the billboard site only becomes assessable if there has been a change in ownership of the billboard site.)[16]

[15] See subdivision (c)(1) of Revenue and Taxation Code section 61, and Property Tax Rule 462.100, subsections (a)(1) and (a)(2).
[16] Two other assessment issues concerning billboards should be briefly discussed. First, a number of billboard properties are located within railroad rights of way, raising the jurisdictional question of whether these properties should be state or locally assessed. In general, all property that is owned or used by a state assessee is assessed by the Board. As with other billboard properties, the entire value of the billboard site should be assessed to the fee owner of the billboard site, in this case, the state assessee. Thus, the only component of a billboard property that should be locally assessed is the billboard improvement. The second issue concerns billboard properties that are also taxable possessory interests. A billboard property that constitutes a taxable possessory interest should be valued as any other taxable possessory interest.