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.
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.
I. Legal Requirements (Title 68, Oklahoma Statutes 2001, § 2848) Railroads, air carriers and public service corporations - Sworn list of schedules.

A. Every railroad, air carrier and public service corporation organized, existing, or doing business in this state, shall, on or before April 15 of each year, return sworn lists or schedules of its taxable property to the Oklahoma Tax Commission as provided by law, or as may be required by the Commission; and such property shall be listed with reference to the amount, kind, and value as of the first day of January of the year in which it is listed; and said property shall be subject to taxation for county, municipal, public school, and other purposes to the same extent as the real and personal property of individuals.

B. The Oklahoma Tax Commission requests certain financial data be included on any statement or schedule including, but not limited to:

1. List of amount, kind and value of all taxable property as of January 1;

2. The amount of capital stock authorized, and the number of shares into which such capital stock is divided, (shares outstanding);

3. The amount of capital stock paid up;

4. The market value of such stock, or if no market value, then the actual value of the shares of stock;

5. The amount of bonded indebtedness;

6. A notarized affidavit indicating the filing to be true, correct, and complete, a company organization synopsis, Oklahoma exempt property worksheet, a system map, and for each state or non United States province where your company has situs, its original cost inclusive of construction work in progress, with accumulated depreciation (OTC Forms 902-1 thru 902-6);

7. Property allocation factors for the system and Oklahoma, inclusive of telephone plant in service, construction work in progress, property held for future use, telephone plant acquisition adjustment, telephone plant adjustment, materials and supplies, and total original cost (Oklahoma and system), percent of original cost in Oklahoma, exempt Oklahoma utility property cost, exempt Oklahoma utility property percent. The number of main stations (Oklahoma and system), and the percentage of main stations in Oklahoma, gross revenues, Oklahoma and system, with the percentage of gross revenues in Oklahoma (OTC Form 903-T);

8. A completed distribution database/computer printout listing, or for new taxing jurisdictions OTC Form 913-DV, identifying the respective taxing jurisdictions where the company in question has situs;

9. A detailed list of all property in each county by city or town, school district and area (vo-tech) school district. The list must be in sufficient detail (including legal descriptions for land and structures) for taxing agents to make proper identification. This form must be filed in duplicate (one copy with original cost, one without original cost), the copy without original cost will be forwarded to the respective county (OTC Form 913-DV);
10. Financial data as of January 1, including selected balance sheet and income statement items, total amount of debt and preferred stock issues, market value of common stock shown by high and low prices each month for the reporting or parent company as is applicable, number of common stock shares outstanding, allocation factors from the parent company if parent company stock information was used (OTC Form 904-T-1 thru 904-T-4);

11. Several years of historical data including plant additions and retirements, net utility operating income, gross operating revenues, net plant investment, gross plant investment, main stations, non-cash expense and cash flow (OTC Form 904-T-5 thru 904-T-6);

12. Investment data as per books of account including common stock, preferred stock, long term debt and deferred income taxes. The rates reported must be embedded (actual) interest on debt instruments. Non-capitalized lease information inclusive of lease payment and depreciation expense for the system and gross and net investment (Oklahoma and system) (OTC Form 904-T-7);

13. Company rendered Oklahoma fair cash value (mandatory). Any construction works in progress and projected year of completion. Allocation factors of net book and original cost Oklahoma and system, and the exempt Oklahoma utility property percent as calculated on OTC Form 903-T (OTC Form 904-T-7);

14. Stockholders report for the year preceding January 1;

15. Balance sheet as of January 1, (audited if possible);

16. Income statement for the year preceding January 1, (audited if possible);

17. Form 10K (if applicable);

18. RUS Form 479 (if applicable).

II. Data Sources

A. OTC - Oklahoma Tax Commission report for Ad Valorem Division purposes

B. Annual report to the Federal Communication Commission

C. Annual report to stockholders

D. Auditors opinion and financial statements

E. SEC – Securities and Exchange Commission Form 10-K

F. Annual filing to Oklahoma Corporation Commission

III. Data Needed for Valuation

A. Cost Approach – Original Cost less Depreciation

1. Original cost of communication plant and equipment recorded by account;

2. Accumulated depreciation recorded in accounts related to communication plant and equipment;
3. Amount recorded in the materials and supplies account;
4. Amount of original cost and accumulated depreciation of any miscellaneous physical property;
5. Balance sheets for the last two years.

B. Income Approach
1. Income statements for the last two years showing income and expense by (FCC) accounts;
2. Statement showing after tax communication operating income (net utility operating income) for each of the last five years;
3. Gross operating income for the past five years;
4. Net plant investment for the past five years;
5. Gross plant investment for the past five years;
6. Number of main stations for the past five years;
7. Cash flow (net operating income plus non-cash expenses) for the past five years;
8. Copies of the latest rulings by FCC as to cost of capital and rate base.

C. Stock and Debt Approach
1. Market value of long term obligations as of January 1;
2. List of long term obligations showing date of instrument, maturity date, interest rate, and amount outstanding as of January 1;
3. Amount of current debt outstanding as of January 1;
4. Market value of preferred stock outstanding as of January 1;
5. List of preferred stock issues showing stated rate, par value and shares outstanding as of January 1;
6. Market value of common stock outstanding as of January 1;
7. Number of shares of common stock outstanding as of January 1. If the reporting company does not have publicly traded stock, then that of the parent company whose stock is publicly traded shall be used;
8. List of high and low prices for the common stock for each of the twelve months proceeding January 1. If the reporting company does not have publicly traded stock, then that of the parent company whose stock is publicly traded shall be used;
9. If the reporting company does not have publicly traded stock, then the original cost, net investment, gross revenue and net income of the parent company
whose stock is publicly traded in addition to that of the reporting company are needed;

10. Amounts payable to affiliated companies as of January 1.

IV. Reporting Tax Exempt Items
A. Oklahoma licensed vehicles, original cost and accumulated depreciation
   1. Total of requested exemptions;
   2. Applicable accumulated provisions for depreciation;
   3. Tag number for all vehicles and indication of type (i.e. sedan, ½ ton pickup, etc.).
B. Producing Oil Wells, original cost and accumulated depreciation.
C. Producing Gas Wells, original cost and accumulated depreciation.
D. Other, original cost and accumulated depreciation and reason for exemption.

V. Valuation Formula
A. Cost Approach – Original cost less depreciation
   1. Depreciated cost of all company plant, including leased property (except CWIP);
   2. Construction work in progress deferred at computed capitalization rate;
   3. Materials and supplies;
   4. Property held for future use;
   5. Other taxable property.

FORMULA: \((#1 + #2 + #3 + #4 + #5)\) = Indicator of system value using Cost Approach based on original cost less depreciation.

B. Income Approach
   1. Net utility operating income and/or cash flow based on one of the following:
      - Five year simple average;
      - Five year weighted average;
      - Most recent year;
      - Trended analysis using linear regression, exponential curve, logarithmic curve and/or power curve analysis.
   2. Actual company capitalization rate or default rate, using the band of investment method. The default rate should be used only when the capital structure of the company is abnormal and unacceptable. Earnings price ratios, capital asset pricing models, discounted cash flow models (dividend growth models) and risk premium models shall all be considered when determining the equity rate.
component for the band of investment. The capitalization rate used should match the level of income being capitalized.

FORMULA: (#1 / #2) = Indicator of system value using the Income Approach.

C. Stock and Debt Approach

1. Market value of equity;
2. Market value of debt;
3. Percentage of taxable property to total property.

FORMULA: [(#1 + #2) x #3] = Indicator of system value using the Stock and Debt Approach.

VI. Correlation

At this point the value indicators must be correlated into a final system value (correlated unit value) based on the appraiser’s best judgement. Generally two or more approaches to value are utilized for this final correlation. However, there may be circumstances whereby only one approach to value is utilized.

For preliminary analysis by the Oklahoma Tax Commission it is recommended that the following weights be used.

A. The income indicator should be weighted from 50% to 80%;
B. The cost or net investment indicator should have a minimum of 20% weight;
C. The market or stock and debt indicator should receive the balance with a maximum weight of 20%.

Note: The proceeding recommended weightings are for preliminary analysis only. Final weights are to be determined by appraisal judgement.

VII. Allocation

A. Main Stations – Oklahoma divided by total equal’s percent in Oklahoma;
B. Original Cost – Oklahoma divided by total equal’s percent in Oklahoma;
C. Gross Revenues – Oklahoma divided by total equal’s percent in Oklahoma.

VIII. Exemptions

A. Original cost of Oklahoma property;
B. Original cost of exempt property in Oklahoma.

FORMULA: [(A – B) / A] = Oklahoma taxable property ratio

IX. Oklahoma Taxable Unit Value

FORMULA: [(Correlated Unit Value x Oklahoma Allocation Factor) x Oklahoma Taxable Property Ratio] = Oklahoma Taxable Unit Value