Chair Patten opened the meeting at 9:30 a.m. Introductions of the board members followed.

Minutes

Minutes of the April 14 and April 28, 2017, regular board meetings were not complete and will be voted on at the next meeting.

Chairman Patten described the handouts provided which include a blank copy of a PA-20 form that the utilities file annually to the Department of Revenue Administration (DRA), a copy of Mr. Bartlett’s PowerPoint presentation from the April 28 meeting and copy of a letter submitted by Gary Roberge on April 19, distributed at the end of the April 28 meeting. The letter was provided to clarify that he does consider all effects of regulation in his appraisal of a utility but he does not apply an adjustment because he feels the positive and negative effects offset each other.

DRA Utility Valuation Method continued

Mr. Hamilton began by acknowledging that a lot of information has been heard about some of the ways appraisals of utilities are completed. This has provided a good opportunity for the board to try to put that information into context to understand what the various appraisal approaches mean and to think about the way the appraisal work flow should be organized to get to reasonable and supportable estimates of value. The following presentation will focus on some of the important concepts by walking through a basic workflow and
process to explain the importance of why some determinations are made and where a direction may change based on how the workflow is used.

The basic idea of appraisal is that the appraiser (1) does not establish value; (2) is not making a determination of what value is; and (3) is creating a mirror for market activity to reflect accurately what the market anticipates and how it reacts. The appraisal workflow described in the Uniform Standards of Professional Appraisal Practice (USPAP) is linear, using a series of steps to identify the client, the user(s), and the type of value to be estimated and then defining that value. A small deviation or variance from the linear path of appraisal could set you off in a different direction.

In determining market value, an appraiser is trying to understand the value of all the rights that are available to the property owner; typically, the bundle of rights. There are a few limitations on utility property by the exercise of police power which include zoning regulation, eminent domain or a limitation on the use of the property by law and regulation of public utility property that may greatly diminish the rights those property owners possess.

Regulation by the Public Utilities Commission (PUC) has significant influence in the way a utility property is owned and operated including who a utility company can sell to its property to. Companies regulated by the PUC occupy a space in the public realm by providing electricity in a safe and reliable way. Assets located within a municipality are small physical segments of a much larger property which must be considered when looking at the characteristics of the property in the process of determining a value. According to USPAP Standards 1 and 2, once you define market value and an effective date of value, the subject property must be identified as a physical segment of a larger property.

The ability to value small physical segments of a much larger property that are not saleable or marketable and cannot be sold separately is considered an extraordinary assumption. Other examples of extraordinary assumptions may include land value estimates that rely on other market indicators such as sales of property or a different use; a neutral impact from the regulation of the property; and the calculation of depreciation in a replacement cost new analysis because these properties are owned in a way to perpetually provide safe and reliable electricity. In a perpetual life property, owners must replace property well before it wears out and the age-life calculation is an extraordinary assumption that comes with a risk; a risk that must be considered and understood and if the assumption is incorrect.

Another consideration is hypothetical conditions which are assumptions that may not be proven but if wrong, could fundamentally undercut a valuation. This leads in a linear pathway to a determination of market value that is based on the property’s highest and best use. The highest and best use determination varies from property to property and must incorporate the previously defined aspects in the appraisal process; the kind of use and the relevant characteristics of the property.

The four tests used to determine the highest and best use of a property are:

1. Is the use that you are looking at physically possible?
2. Is the use legally permissible?
3. Is the use financially feasible?
4. Is it the maximally productive use of the property?

Determining the highest and best use for a property in a single town is a straightforward process however valuing a property located in more than one town is a more difficult process. To understand the small physical segments of property located in any of the towns, it helps to understand the value of the whole property and then to understand how a change to one part of the property can impact the value of the other relating segments.
Valuing a portion of the property located in one town also does not take into consideration the highest and best use of the entire property. Therefore, the value of the entire property needs to be determined and then the value allocated to the respective property in each of the towns.

In example of an industrial property located within Manchester and Londonderry, Mr. Gagne stated that each town lists the entire property; the tables generate the value and each town makes an adjustment to the percentage within each town. He added this is the same process used for other properties located in Manchester and Goffstown and land value is the value listed within each town. He added that a town cannot legally choose which town gets to assess a multi-jurisdictional property; the value is determined by each town for the property located within its boundaries.

Mr. Hamilton restated that the context of the physical property matters and when there is greater complexity, for example PSNH utility property located in 219 towns, the appraisal process should be followed. The more complex the property; the more reliance should be placed on the appraisal standards, processes and practices. He added that regulation deeply impacts the highest and best use of a property and excluding that limitation doesn’t seem to reflect a true mirror of the market place.

Mr. Hamilton explained a service territory map showing the boundaries of Brentwood, Fremont, Danville, and Kingston as well as the customers of Eversource/PSNH, NH Electric Co-op and Unitil within each of the utility service territories. There are some service territories that end at the municipal boundary but the electric systems were not generally created by municipal boundaries and they do not function or operate that way. It is difficult to try and understand the value of property isolated from the rest because one property counts on all the other properties to have its value and to provide service. There is no interconnection of utility service wires, when one utility line ends it ends, it does not connect to another utility. So, to determine the highest and best use of the property located in one of its small, physically separated segments, you would have to consider a negative adjustment to account for the inability to separate it from the larger unit because it cannot be separated or sold off. That creates a limit on the marketability and severability from the rest of the unit. An appropriate economy of scale adjustment also needs to be considered to account for the physical property in located in one town in the context of the whole unit.

Mr. Hamilton was asked if he saw appraisals following the process he just explained. In response, Mr. Hamilton restated you could either start from the top, value down, and allocate and apportion correctly or start from the bottom up as long at the appropriate adjustments are integrated to recognize costs such as making a physical separation and installing the equipment to do so. If you were to say that the highest and best use is the property located in one town, there are costs that must be understood and integrated into the valuation as well as other considerations and permissions. Determining the highest and best use of a physical segment of a property valued in one town can be answered by asking the questions (1) can the assets in one town be severed and sold off separately from the rest of the property; (2) is that the maximally productive use of that property or would being part of the larger system be a more productive use; and (3) would it return a higher profit to the property? If you don’t go through that step, you take a turn off that appraisal work flow in a way that you can’t back up from.

With regards to the highest and best use and economic considerations, Mr. Dickman added the foundational issue is that this all begins with the legal permissibility and the assumption the PUC would allow it to be severed and if severed, it would have to satisfy all the PUC’s requirements that it remain reliable.

Mr. Hamilton confirmed the DRA values this property for equalization purposes. We know that it is different wherever it is located and we value the property the way the market appears to value it. We complete a cost approach which follows the real-world limitations on the utility’s ability to earn money on the investments they make to the property; we complete an income approach using market evidence to understand what the anticipated rates on return are for owning this type of property the way it is organized and used; we integrate
the market into these determinations and finally find a way to allocate or apportion the value to each of the communities in the same way.

In a brief moment in the discussion, Senator Gray introduced Senator Bob Giuda who has been appointed to the board and had just arrived. Senator Giuda lives in the town of Warren and represents District 2 which includes towns in Grafton, Merrimack and Belknap Counties.

Mr. Dickman began his presentation with an example of appraising a single-family home in disrepair. One way to value the home would be to use comparable sales in disrepair which would not require significant adjustments. The other way to value the home would be to find comparable sales in excellent condition and apply adjustments. The local assessor is charged with appraising the assets in their respective town and they must also get back to the same highest and best use relative to the property rights. In theory, whichever way you value the single-family residence, you should get back to the same value; not necessarily the cost but the same market value.

Mr. Dickman explained his statutory and constitutional charge to simulate the market which includes matching rates and cash flows. In the valuation of a commercial property for assessment purposes, using an income approach, property taxes are backed out of the expenses and then added back into the rate to balance the cash flow and the rate. In the context of the utility market, all the rates are based on after tax therefore the cash flow must be assembled on an after-tax basis. He also considers the impact of flotation costs, which is not done at the local level. Flotation costs represent points and fees, like a mortgage, which may be considerable based on where the market is at a certain time. No firm or corporate entity can acquire the necessary debt and elements of equity without the consideration of flotation costs. If flotation costs are excluded, you are stepping away from the way the market operates. He also adjusts for interest on debt.

When developing the capitalization rate, an adjustment is made to the interest on debt in both the interest expense and the return on equity as opposed to using the current market rate. Mr. Dickman explained the adjustment is current because it is predicated on both the degree of flotation costs (like any other financial and market variable) and income taxes. The adjustments are necessary and must be properly reflected in the development of the capitalization rate; if he were to zero them out, it would result in a higher value.

Mr. Dickman addressed the confusion surrounding the “backing out” of the depreciation. Because the rates are after tax, depreciation is deducted from the appraisal to properly calculate the income taxes and then is added back in therefore resulting in a net impact of zero. The income tax is then deducted to reflect the after tax calculation. This process is simply matching the rates with the cash flow. The capital expenditures (cap-ex) or the replacement allowance is a textbook driven requirement to preserve the perpetual, financial and physical continuity of the asset; it assumes the short-live assets like roofs, elevators, etc. that require periodic replacement. The cap-ex replacement allowance is deducted because that is what is required to match the cash flow.

Mr. Hamilton offered some clarification about the terms cap-ex and capitalization rates. The two terms are unrelated. Cap-ex refers to a capital expenditure; the expense of replacing parts of a system on a regular basis. Because a utility is a perpetual investment, there is no fixed end to its life and therefore all the assets need to be replaced and the expenses to replace those assets through the passage of time must be included when using an income approach to valuation.

Mr. Gagne asked if a utility property is meant to last forever, wouldn’t all of the assets be considered short-lived? Mr. Dickman responded yes. Another way to think about that is; it is simply the replacement of the same expense and maintaining the status quo as of the date of value; it is not the addition of assets. As with a regular appraisal with a capitalization rate, there is an assumption about the implicit perpetuity.
Mr. Dickman described obsolescence as an economic adjustment to prepare for how depreciated assets are performing relative to the market. When determining the highest and best use of a property, the non-severability cannot be ignored and the notion that the market for regulated property having zero obsolescence is counterintuitive. When a property is subject to regulation, there is a fundamental deduction in value that we are able to quantify using discounts for marketability.

Mr. Brown asked Mr. Dickman to talk about allocation. Mr. Dickman stated the allocation employed by the department is foundational unit theory which begins with the highest and best use of the originating asset. We begin our analysis by understanding the value of the integrated whole and work our way down. Due to the unavailability of net operating income, the most uniformly adhered to allocation metric is original cost because this is what the company can earn a return on. The cost basis the department utilizes is the gross cost basis because there are assets that have fully depreciated and the notion of assigning zero value for that asset however large or small, in his opinion, was counterintuitive so he relies on the gross basis and allocates accordingly. The implicit relationship between the rates can change based on the net book value, their rate base, etc., and while the gross cost is a little bit more excessive than what they can earn a return on, he weighs that against not allocating elements of value to a particular municipality and by doing so, introduces an imperfection that favors the municipality.

Mr. Hamilton added one benefit of using original cost to allocate is that it weights the dollars spent in every community the same way. For example, when a dollar is reinvested into the system, it has the same impact on the allocation; it has the percentage of the value of the unit that gets assigned to each of the communities.

Mr. Gagne clarified the purpose and reason for allocation by the department is for equalization purposes and when RSA 83-F was adopted by the legislature, it was not intended that the department’s value be used to directly tax utilities within individual municipalities. Mr. Hamilton stated that was correct. The equalization process looks to find the total market value of a community in order to understand shared common taxes like the county tax burden. We value land, building and manufacture housing, using local assessed values and an understanding between local assessed value and market value. We then calculate and apply the ratio to the total value and adjust those local assessed values to market value. There is no ratio for utility property; no sale of the small segments of the utilities and no way to adjust the assessed value to market value. RSA 21-J:3, states that when a property cannot be valued using the primary process; it is valued using an appraisal. The appraisal the department uses is RSA 83-F and the appraisal step we take is allocation. Mr. Dickman added that USPAP validates that allocation is a value not merely a mathematical expression and it is used nationwide.

Mr. Michaud stated the work flow discussed earlier mentioned intended users and as the municipalities do not receive copies of these appraisals, they are not an intended user. He suggested including a mandate in this legislation that the municipalities receive copies of these appraisals before September 1. One other point is the allocation process is not governed by any state law, regulation or administrative rule and suggested that may be something to consider in the future.

Mr. Hamilton agreed with Mr. Michaud and stated there are intersections of laws that create difficulty in the department’s ability to communicate the appraisal because it includes sensitive financial information reported to us and the department is statutorily bound to not release any taxpayer information. The laws under RSA 21-J:14 could address the ability to communicate some part of the information at least the results to the communities. The department would consider any way to make the process more visible and transparent to the towns and agreed it is something that could be improved upon.

Mr. Vincent, pertaining to the allocated values, asked whether allocated values could vary greatly from year-to-year in a specific community and if yes, why. Mr. Dickman replied that the allocated value can only be understood and have credibility in the context of the entire property. The unit methodology considers all the assets distributed throughout the state germane, necessary and vital to the overall function of the entire property
so when assets are added or removed from one town, everything else will shift. Similar to a tax bill, your tax burden will change based on what your neighbors do with their property while you have not made any changes to yours. The most dramatic shifts occur when there is a new replacement or creation of a new system within a particular municipality.

Mr. Vincent asked how allocated values are determined for each community. Mr. Hamilton replied it is simply a percentage share of the total value of the entire unit. We figure out the value of the whole unit then; based on original cost, find the percentage of the total value in a particular town.

Mr. Stohl asked exactly what information the DRA received that could not be released. Mr. Hamilton stated federal tax returns and Mr. Dickman added operating and purchase power agreements and other documents that do not ordinarily make their way into the public domain.

Mr. Brown asked Mr. Dickman if Contributions in Aid of Construction (CIAC) were included in the original cost. He replied he did allow it. Mr. Dickman clarified the department does not use cost as a basis for value; they develop a value. Mr. Brown asked how original cost compared to the total assessment. Mr. Hamilton stated they could not answer that question and to remember the important thing about undepreciated original cost is the relationship between each community’s share of that cost; not the relationship between original cost and final value. The original cost is used only the figure out the percentage of value within a community and then apply that percentage to the total value.

Mr. Gerzon asked why the department does not allocate based on the actual assessments received. Mr. Hamilton replied that any allocation formula will result in a set of winners and losers and he would guess that kind of approach would create a larger set of losers. Mr. Gerzon continued that while the original cost is thought to be the best method for allocation, what if an allocation formula were developed based on the entirety of all the valuation in the towns using the non-utility segments as an alternative since utilities whether water, gas or electricity, are all part of the infrastructure of value that resides in a town. A discussion followed.

Senator Giuda stated he had talked with a couple of utilities with the idea of establishing a stabilization rate and/or fund to mitigate over a period of time to get away from the disparities in the utility valuations. He also approached utilities in an effort to reduce energy costs and asked for individual costs of their energy product. He was given a response that in the interest of being competitive that information is confidential. He felt their response was conflicted and counterintuitive to being competitive and it could be something to look at.

Mr. Gagne stated he would be interested in Mr. Gerzon’s allocation suggestion however he sees a couple problems, one being what happens to the equalized tax base when a utility is located in multiple municipalities? He thought the information would be available at the DRA but the analysis would take some work. Mr. Hamilton stated that would take a massive undertaking and significant effort because finding the value of property for PSNH customers would be difficult. Mr. Gerzon asked if a utility shared a community, why they wouldn’t share the same allocating factor for their system, for that town. Chairman Patten stated there are other things the board needed to talk about and allocation could be discussed further at another time.

Mr. Michaud asked Mr. Hamilton if there was a legal requirement, law or rule that explicitly requires communities to equalize current use values. Mr. Hamilton responded there is no explicit statement.

Ms. Noel stated there has been a lot of time spent talking about electric companies and she wanted to make sure that all of the utilities were being included in the discussions and treated the same way, including any differences. She would like to hear more about the generation aspect of the utilities. Mr. Hamilton stated Unilil employs both gas and electric distribution and transmission and similar forces impact those functions for the gas, electric and water companies. The PUC also explained that regulated properties do not include generating facilities as they are stand-alone, unregulated, merchant facilities. The subject of the discussion is the regulated
utility property and the distribution and transmission systems of gas, electric and water. Mr. Gagne clarified the proposed legislation did not make that distinction in its suggestion of the local jurisdictions using the DRA values. It needs to be clear what is going to be legislated and what will be excluded, such as merchant utilities. Mr. Giegerich added the PUC regulates both distribution and transmission facilities. The PUC sets the rates for facilities and transmission lines within NH; FERC sets rates for those facilities and transmission lines that are located in more than one state.

Utility Matrix

Chairman Patten discussed the intent of the matrix and definitions distributed. The matrix is an effort to collect the information in a simplified, clear way to present to the House Committee. She requested the board members review the documents and bring suggestions to the next meeting for discussion.

Meeting Schedule

Friday, May 26, 2017, at 9:30 a.m. at the Legislative Office Building (LOB) - Room 303
  • Unitil Presentation

Friday, June 9, 2017 at 9:30 a.m. at DRA
  • George Sansoucy Presentation

Friday, June 23, 2017, at 9:30 a.m. at the Legislative Office Building (LOB) - Room 303
  • George Sansoucy Presentation continued
  • Gather information received and discuss how to present the information to Legislature

Mr. Gagne motioned to adjourn. Mr. Vincent seconded.

Chair Patten adjourned the meeting at 12:10 p.m.

Respectfully submitted,
Stephanie Derosier

Municipal and Property Division
NH Department of Revenue Administration

All meetings are recorded and are available upon request.

Documentation relative to the Assessing Standards Board may be submitted, requested or reviewed by:

Telephone: (603) 230-5096
Facsimile: (603) 230-5947
Web: www.revenue.nh.gov
E-mail: asb@dra.nh.gov

In person at:
109 Pleasant Street, Concord

In writing to:
NH Department of Revenue
Assessing Standards Board
PO Box 487
Concord, NH 03302-0487