STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**6/5/01**	Bill No:	**AB 81**
Tax:	**Property**	Author:	**Migden**
Board Position:		Related Bills:	

BILL SUMMARY

This bill would specify that the Board of Equalization is to assess certain electric generation facilities with a generating capacity of 50 megawatts or more. Additionally, it would establish special revenue allocation procedures for these facilities.

ANALYSIS

Current Law

Section 19 of Article XIII of the California Constitution provides that **"[t]he Board shall annually assess** * * * property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and **companies transmitting or selling gas or electricity.**"

Under existing assessment practices, some electrical generation facilities are assessed by the Board of Equalization (i.e. "state assessed") while others are assessed by local county assessors (i.e. "locally assessed"). State assessed property is revalued every year at its current fair market value. In contrast, locally assessed property is subject to Proposition 13 value limitations, which generally means acquisition value with annual increases limited to no more than 2%.

Local county assessors have historically assessed all electrical generation facilities except those owned by the regulated public utilities. As a result of electrical deregulation, twenty-two electrical generation facilities previously owned by public utilities were sold to private companies. As an additional consequence of deregulation, it was anticipated that non-public utility companies would construct future generation facilities. As a result of these developments, the Board decided to examine the question of the boundaries of its assessment jurisdiction over companies selling electricity in a post-deregulation era.

Formal discussion of assessment jurisdiction began in November of 1998 and a series of Board hearings and interested parties meetings were held. Following a public hearing on July 29, 1999, and after accepting and publishing proposed amendments, the Board, on September 1, 1999, adopted Rule 905, *Assessment of Electric*

Generation Facilities. Rule 905 was approved by the Office of Administrative Law, and became effective on November 27, 1999.

Property Tax Rule 905, provides that electrical generation facilities will be state assessed only if:

(1) "the facility was constructed pursuant to a certificate of public convenience and necessity issued by the California Public Utilities Commission to the company that presently owns the facility; or,

(2) the company owning the facility is a state assessee for reasons other than its ownership of the generation facility or its ownership of pipelines, flumes, canals, ditches, or aqueducts lying within two or more counties."

In practical application, this generally limits state assessment of electrical generation facilities to those owned by rate regulated public utilities, such as Pacific Gas and Electric Company. Consequently, after the regulation was adopted, the jurisdiction to assessee the 22 conveyed electrical generation facilities was transferred from the Board to the local assessors in the counties in which the facilities are located.

Proposed Law

This bill would add Section 721.5 to the Revenue and Taxation Code to provide that:

> (a) (1) Notwithstanding Section 721 or any other provision of law to the contrary, the Board shall annually assess every electric generation facility with a generating capacity of 50 megawatts or more that is owned or operated by an electrical corporation, as defined in subdivisions (a) and (b) of Section 218 of the Public Utilities Code.
>
> (2) For purposes of paragraph (1), "electrical generation facility" does not include a qualifying small power production facility or a qualifying cogeneration facility within the meaning of Sections 201 and 210 of Title II of the Public Utility Regulatory Policies Act of 1978 (16 U.S.C. Secs 796 (17), (18) and 824a-3) and the regulations adopted for this sections under that act by the Federal Energy Regulatory Commission (18 C.F.R. 292.101-292.602).
>
> (b) This section shall be construed to supersede any regulation, in existence as of the effective date of this section, that is contrary to this section.

Public Utilities Code Section 218 (a) defines "electrical corporation" as including every corporation or person owning, controlling, operating, or managing any electric plant for compensation within this state, except where electricity is generated on or distributed by the producer through private property solely for its own use or the use of its tenants and not for sale or transmission to others.

Section 218 continues:

(b) "Electrical corporation" **does not include** a corporation or person employing **cogeneration technology** or **producing power from other than a conventional power source** for the generation of electricity solely **for any one or more of the following purposes:**

(1) Its **own use** or the use of its tenants.

(2) The use of or sale to not more than two other corporations or persons solely **for use on the real property on which the electricity is generated or on real property immediately adjacent thereto**, unless there is an intervening public street constituting the boundary between the real property on which the electricity is generated and the immediately adjacent property and one or more of the following applies:

(A) The real property on which the electricity is generated and the immediately adjacent real property is not under common ownership or control, or that common ownership or control was gained solely for purposes of sale of the electricity so generated and not for other business purposes.
(B) The useful thermal output of the facility generating the electricity is not used on the immediately adjacent property for petroleum production or refining.
(C) The electricity furnished to the immediately adjacent property is not utilized by a subsidiary or affiliate of the corporation or person generating the electricity.

(3) **Sale or transmission to an electrical corporation or state or local public agency, but not for sale or transmission to others,** unless the corporation or person is otherwise an electrical corporation.

Additionally, this bill would add Section 100.9 to the Revenue and Taxation Code to change the allocation of property tax revenue from the affected facilities to tax rate area situs rather than the existing county-wide system used for most other state assessed property.

Background

Electrical Restructuring: Existing Facilities and New Facilities

As a result of the restructuring of the electric utility industry in California (AB 1890, Stats. 1996, Ch. 854), rate regulated public utilities have sold many of their electrical generation facilities. Public utilities were required to sell certain generation facilities, and have opted to sell other facilities voluntarily.

These previously state assessed plants were sold between 1998-1999 and are currently subject to local assessment.

Seller – Buyer – Sales Price	**Plants**	**County**
PG&E to Duke Energy	Moss Landing	Monterey
$501 Million for 3 Plants	Morro Bay	San Luis Obispo
	Oakland	Alameda
PG&E to Southern Energy	Pittsburg Power Plant	Contra Costa
$801 Million for 3 Plants	Contra Costa	Contra Costa
	Potrero	San Francisco
PG&E to Calpine Corp.	The Geysers	Sonoma
$213 Million for 2 Plants	The Geysers	Lake
Southern California Edison to AES	Alamitos	Los Angeles
$781 Million for 3 Plants	Redondo Beach	Los Angeles
	Huntington Beach	Orange
Southern California Edison to Reliant	Ormand Beach	Ventura
$280 for 5 Plants	Etiwanda	San Bernardino
	Cool Water	San Bernardino
	Mandaley	Ventura
	Ellwood	Santa Barbara
Southern California Edison to NRG/Destec	El Seguno	Los Angeles
$117.5 Million for 2 Plants	Long Beach	Los Angeles
Southern California Edison to Thermo-Ecotek	Highgrove	San Bernardino
$9.5 Million for 2 Plants	San Bernardino	San Bernardino
San Diego Gas & Electric to San Diego Unified Port District (Operated by Duke) $110 Million	South Bay Power Plant	San Diego
San Diego Gas & Electric to Dynergy/NRG $356 Million	Encina Power Plant	San Diego

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

Additionally, the restructuring and subsequent opening of electrical generation to competition has resulted in the planned development and construction of many new electrical generation facilities across the state. According to the California Energy Commission, "In the 1990s before the state's electricity generation industry was restructured, the California Energy Commission certified 12 power plants. Of these, three were never built. Nine plants are now in operation producing 952 megawatts of generation; one of them has a Phase 2 project that is nearing completion and will add an additional 44 megawatts by May 2001. Restructuring occurred in March 1998. Since April 1999, the Energy Commission has approved nine major power plant projects with a combined generation capacity of 6,278 megawatts. Six power plants, with a generation capacity of 4,308 megawatts are now under construction, with 2,368 megawatts expected to be on-line by the end of the year 2001. In addition, another 15 electricity generating projects, totaling 7,126 megawatts of generation and an estimated capital investment of more than $4.8 billion, are currently being considered for licensing by the Commission. The California Energy Commission has the statutory authority to site and license thermal power plants that are rated at 50 megawatts and larger and related transmission lines, fuel supply lines and other facilities." Please see http://www.energy.ca.gov/sitingcases/index.html

Assessment of Facilities: State <u>and</u> Local

Article XIII, Section 19 of the California Constitution, provides that the Board of Equalization is to annually assess the property of companies selling or transmitting electricity. The Board has historically self-restricted its assessment jurisdiction to companies selling or transmitting electricity that were rate regulated and operating pursuant to a certificate of public convenience and necessity by the PUC or a comparable license from a regulatory agency. Property owned by other types of companies selling or transmitting electricity traditionally have been assessed by county assessors. These companies typically operate co-generation facilities, small power generation facilities, or generation facilities using renewable energy resources.

As a result of the restructuring of the electrical energy industry and its regulation the Board adopted a regulation, Property Tax Rule 905, essentially limiting its jurisdiction to those facilities that are owned by public utilities. Under this regulation, the existing electrical generating facilities purchased from public utilities in the late 1990's are currently locally assessed, and newly constructed plants to be built by non-public utility companies, such as Calpine, AES, Duke Energy, and Southern Energy, will also be locally assessed.

Property Tax Revenue Allocation

Prior to Proposition 13, each local government with taxing powers (counties, cities, schools, and special districts, etc.) could levy a property tax on the property located within its boundaries. Each jurisdiction determined its tax rate independently (within certain statutory restrictions). In total, the statewide average tax rate prior to Proposition 13 was 2.67 percent. After Proposition 13, the property tax rate was limited to a maximum of one percent of a property's assessed value.

Since local jurisdictions could no longer set their own individual tax rates and instead were required to share in a pro rata portion of the maximum one percent tax rate, the Legislature was given the authority to determine how the property tax revenue proceeds should be allocated. The legislation that established the current property tax allocation system, found in Revenue & Taxation Code §95 - §99.2, was Assembly Bill 8 (Stats. 1979, Chap. 282; L. Greene). The descriptive term for the allocation procedure for locally assessed property tax revenues is still commonly referred to as "AB 8," some twenty years later.

In addition to establishing allocation procedures, AB 8 also provided financial relief to local agencies to offset most of the property tax revenue losses incurred after Proposition 13. AB 8 provided relief in two ways: first, it reduced certain county health and welfare program costs and, second, it shifted property taxes from schools to cities, counties and special districts, replacing the school's lost revenues with increased General Fund revenues. (There were six counties - Alpine, Lassen, Mariposa, Plumas, Stanislaus, and Trinity – referred to as "negative bailout" counties, where the amount of property taxes allocated to the county was *reduced* because the health and welfare components of AB 8 were so favorable to those counties.)

In 1992, the Educational Revenue Augmentation Fund (ERAF), was established. ERAF partially reversed the relief provided to local agencies by AB 8. The effect of ERAF was to redirect a portion of property tax revenues previously allocated to cities, counties, and special districts to schools, thus reducing the state's General Fund obligations for funding schools under Proposition 98.

Additional information on these property tax allocation procedures can be obtained from various publications authored by the Legislative Analyst's Office (LAO) and available online at http://www.lao.ca.gov.

Allocation Generally

- "Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes", LAO Report, February 2000
- "Property Taxes—Why Some Local Governments Get More Than Others", LAO Policy Brief, August 1996
- "Why County Revenues Vary: State Laws and Local Conditions Affecting County Finance", LAO Report, May 1998

Allocation and ERAF

- "Reversing the Property Tax Shifts", LAO Policy Brief, April 1996
- "Property Tax Shift", Perspectives and Issues (pp. 203 - 213), February 1997
- "Improving Incentives for Property Tax Administration", Perspectives and Issues (pp. 215 - 226), February 1997
- "Major Milestones: 25 Years of the State-Local Fiscal Relationship", California Update, December 1997
- "Shifting Gears: Rethinking Property Tax Shift Relief", LAO Report, February 1999

Locally Assessed Property. Generally, property tax revenues from locally assessed property are allocated by the situs of the property and accrue only to the taxing jurisdictions in the tax rate area where the property is located. A tax rate area is a grouping of properties within a county wherein each parcel is subject to the taxing powers of the same combination of taxing agencies.

State Assessed Property. Under current law, the allocation procedures for property tax revenues derived from state assessed property are different than those for locally assessed property. The revenue allocation system for state assessed property was established by legislation enacted in 1986 via AB 2890 (Stats. 1986, Chap. 1457). Prior to the 1988-89 fiscal year, the property tax revenues from state and locally assessed property were allocated in the same manner – by tax rate area. However, the process of identifying property according to tax rate area had become overwhelming for state assessees. As a result, AB 2890 was enacted to simplify the reporting and allocation process for state assessees. It allowed state assesses to report their unitary property holdings by county rather than by individual tax rate area. It additionally allowed the Board to allocate value by county rather than by tax rate area. This change allowed state assessees to receive only one tax bill per county. Previously, each state assessee received hundreds of property tax bills from each county where they owned property because a separate tax bill was prepared for each tax rate area where property was physically located. Statewide there are nearly 58,000 tax rate areas.

Essentially, AB 2890 established a prescribed formula, performed by the county auditor. The results of AB 2890 are as follows:

- Preserves each local agency's tax base (hereafter called the "unitary base") for any jurisdiction which had state assessed property sited within its boundaries in the 1987-88 fiscal year.
- Thereafter, annually increases each local agency's "unitary base" by two percent (provided revenues are sufficient).
- If, after each local agency has been distributed its "unitary base" plus two percent, there is any property tax revenue remaining, then this surplus revenue, referred to as "incremental growth," is distributed to all agencies in the county. Agencies with unitary bases also receive a share of the incremental growth.
- "Incremental growth" revenues are shared with all jurisdictions in the county (i.e., county-wide distribution) in proportion to the entity's share of property tax revenues derived from locally assessed property.
- It is often stated that all state assessee revenue is shared "county-wide," but this is not technically true. In essence, it is only incremental growth that is distributed "county-wide" without regard to where the growth in value took place or where new construction occurred.
- By establishing unitary bases, jurisdictions were held harmless by the allocation system established by AB 2890 and some jurisdictions (those which had little or no state assessed property located in their jurisdictional boundaries prior to AB 2890)

have since benefited from the county-wide system established for sharing the incremental growth.

Special Situations; Local Agencies Created After 1988 and ERAF.

Local agencies that did not exist prior to 1988, which would include ERAF, have a unitary base of *zero*.

- These local agencies may, however, still receive a share of state assessee revenues. However, their share would consist only of a portion of the county-wide incremental growth pool, if any, since they have no "unitary base."
- Once a local agency is granted a portion of the county-wide pool, it is thereafter annually guaranteed some amount of state assessee revenues.
- In some instances, local agencies and *ERAF receive no property tax revenues* from state assessed property. This occurs when:
  - The local agency was not in existence prior to 1988 and;
  - Since the local agency's formation, there has not been a year when there were sufficient revenues to give those local agencies that received property tax revenues in the prior year their previous year's share plus two percent.

Related Legislation

Electrical deregulation legislation was silent as to the state or local assessment of electrical generation facilities after deregulation. Thereafter, in 1999, SB 329 (Peace) and SB 438 (Rainey), would have given *county assessors* assessment jurisdiction over electrical generation facilities, including power plants, cogeneration facilities, and new generation facilities purchased or constructed after January 1, 1997, by an entity other than a regulated public utility company. These bills were introduced in response to pending rule activity by the Board of Equalization. At that time, the staff of the Board had been proposing a rule that would have placed under state assessment companies owning generation facilities with a capacity of 50 megawatts or more <u>and</u> selling more than 50% of their generated electrical power for transport through the statewide grid. For a variety of reasons, many interested parties, both local government and industry, were opposed to this proposal. The fundamental issue underlying the introduction of both SB 329 and SB 438 was the property tax revenue allocation that would occur under state assessment. Under local assessment, the property tax revenues from new facilities would flow to the government agencies in the tax rate areas in which the facilities were located. Under state assessment, on the other hand, the property tax revenues from the new facilities would be treated as "incremental growth" to be shared with all local governments in the county. These bills were ultimately amended to frame the legislation in terms of revenue allocation rather than assessment jurisdiction. Specifically, revenue from newly constructed facilities would be allocated according to situs, i.e., limited to the local governments where the property was located. Since the rule ultimately adopted by the Board resulted in local assessment of the electrical generation facilities in question, however, these bills were no longer pursued.

COMMENTS

1. **Sponsor and purpose of the bill.** This bill is sponsored by the author. Its purpose is to require the Board of Equalization to assess these plants in order to require annual fair market value assessments of electrical generation facilities of 50 MW or more.

2. **Amendments.** As amended June 5, this bill would *exclude* from state assessment property owned by certain types of companies selling or transmitting electricity – co-generation facilities, small power generation facilities, and generation facilities using renewable energy resources - that have always been assessed by county assessors. Additionally, the amendments change the revenue allocation from state assessed facilities to provide that the revenue derived would be distributed by situs (i.e. tax rate area).

   As amended May 30, this bill would have transferred to the Board of Equalization *all* plants at and over a 50MW threshold, including those that have always been locally assessed.

3. **Supercedes Rule 905**. This measure would effectively negate Rule 905 and transfer the 22 transferred facilities back to the Board for state assessment. Additionally, facilities constructed for 50 MW or more in the future would also be subject to state assessment. In addition to the 22 facilities, this bill would require the Board to assess two plants which have been completed since Rule 905 became effective, 11 plants certified for construction but not yet complete, and 6 plants pending certification.

4. **The Property Tax Committee of the Board will revisit Rule 905 on June 20, 2001**. The Chair of the Property Tax Committee, State Controller Kathleen Connell, has scheduled a discussion of the subject of assessment jurisdiction on June 20. If the Board were to ultimately decide to pursue changes to or repeal the current rule, then such changes must be made through the formal rule making process. This process would generally take at least four months to complete.

5. **This bill should contain a specific appropriation to the Board.** This bill proposes that the Board assess approximately 41 electrical generation facilities on or after January 1, 2002, which is in the middle of the state's fiscal year. In order to value the plants and hire appropriate staff, an adequate appropriation would be required to cover the Board's administrative costs that would not be identified in the Board's 2001-02 budget. While the Board previously assessed 22 of the 41 plants, they were never valued separately; rather they were included in the public utilities unitary value. Consequently, establishing a separate valuation for each plant is an increase in the Board’s workload.

6. **State assessment requires annual fair market assessments.** A key difference between state assessment and county assessment is that under county assessment the valuation provisions of Article XIIIA (Proposition 13) apply, including establishing a base year value, a limit of 2% on annual increases, and valuation on the lower of fair market value or adjusted base year value. These provisions do not apply to state assessed property, which is valued annually at fair market value in accordance with the holding in the case of *ITT World Communications, Inc. v. San Francisco* (1985) 37 Cal.3d. 859. The fundamental differences in state vs. local assessment is noted in the following table:

	State Assessment	**Local Assessment**
Valuation Method	Current Fair Market Value	Acquisition Value Factored By No More than 2% per year or Current Fair Market Value, whichever is lower.
Revenue Allocation	Unitary Base + "County Wide" Incremental Growth	Situs Based
Value Setting	Board Members	County Assessor
Appeal of Value	Board Members	Assessment Appeals Board
Court Actions	Trial *de novo*	Legal Issue – Trial *de novo* Factual Issue - Review of Administrative Record

7. **The value setting process.** In the valuation process, Board staff prepares 3 or 4 value indicators using general appraisal techniques. These techniques would include the replacement cost less depreciation approach, the income approach (capitalized earnings ability), the sales comparison approach, and the historical cost less depreciation approach. Board staff would then weigh the values indicated by the

various approaches to value as to which would be most reliable and appropriate for the industry and for the particular plant (i.e. new plant, old plant, recently sold etc.) as of each January 1 (the lien date). Those value recommendations would be presented to the Board and the Board Members would then set the value.

8. **From a purely theoretical perspective, one might expect the annual fair market value of electrical generation facilities to result in a value that is higher or equal to its Proposition 13 value.** However, real estate appraisal is somewhat subjective and opinions of value differ. There is no guarantee that the values determined by the Board would be higher, lower, or the same than if the plants were assessed by local county assessors.

9. **The purpose of the uncodified language.** This bill specifically addresses only revenue allocation and assessment jurisdiction issues. Section 3 of the bill includes uncodified language that states: "This act shall not be construed to affect the manner in which property to which this act applies is assessed by the State Board of Equalization." According to the author's office, the purpose of this language, which was recommended by Legislative Counsel, is to clarify that the bill is not intended to change any other element, including valuation procedures, for electrical generation facilities.

10. **The Legislature has established the precedent of situs-based revenue allocations for certain state assessed properties newly constructed after the county-wide system was established.** With respect to any change in the revenue allocation from future or existing electrical generation facilities that may be state assessed, the Legislature has approved three exceptions (§100(i)[1], (j)[2], and (k)[3]) to the revenue allocation system for state assessed property established by AB 2890. (One of these exceptions is for a power plant that was ultimately never built.) Those exceptions ensured that, for three specific projects to be constructed by public utilities, their property tax revenue would be allocated as if they were subject to assessment by the county assessor. Hence, the property tax revenues derived from these proposed projects (only two of the three projects were subsequently constructed) would go to the jurisdictions in the tax rate area where the project was to be sited rather than shared with all jurisdictions located in the county as "incremental growth."

11. **The special revenue allocation procedures would not affect all generation facilities.** These revenue allocation procedures would not apply to generation facilities still owned by the public utilities which are currently assessed by the Board (i.e. hydro-electric plants and nuclear plants).

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[1] A computer center in the City of Fairfield (Pacific Bell).
[2] An education and training center in the City of Livermore (PG&E).
[3] For a proposed power plant in the City of Chula Vista (SDG&E), which was never constructed.

12. **Suggested technical amendment.** According to information provided to the Board by county auditors, as currently drafted, the tax rate applied to the assessed value of each facility would be the blended county-wide rate rather than the tax rate specific to the tax rate area where the property is located. The county-wide tax rate could be higher or lower. To correct this, the following amendment is recommended to proposed Section 100.9:

> (2) The ~~total~~ tax rate applied to the assessed value allocated pursuant to subdivision (a) shall be the ~~sum of the rates calculated pursuant to subdivision (b) of Section 100~~ <u>the rate calculated pursuant to Section 93.</u>
>
> (3) The revenues derived from the application of the ~~total~~ tax rate ~~described in subdivision (b)~~ to the assessed value allocated to a tax rate area pursuant to subdivision (a) shall be allocated among the jurisdictions in that tax rate area, in those same percentage shares that property tax revenues derived from locally assessed property are allocated to those jurisdictions in that tax rate area.

COST ESTIMATE

The Board would incur costs of $96,000 in the first year, $218,000 in the second year and thereafter ongoing annual costs of $253,000.

REVENUE ESTIMATE

Pending.

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