



MEMO

To Sherrie Kinkle – California Board of Equalization
From Christopher G. Cothran, Manager, Property Tax – Nextera Energy Resources, LLC
Date February 17, 2012
Subject Guidelines for Active Solar Energy Systems New Construction Exclusion – Additional Comments After Interested Parties Meeting/Call Held on January 26, 2012

The purpose of this memorandum is to provide the California Board of Equalization (“CA BOE”) with NextEra Energy Resources, LLC’s questions and comments regarding the areas of discussion and points that were made during the Interested Parties Meeting hosted by the CA BOE on January 26, 2012. We appreciate the opportunity to be a part of this process and respectfully submit the following for your review.

Our requests for clarification specifically relate to the Decline in Value Section, page 11 of the Draft Guidelines for Active Solar Energy Systems New Construction Exclusion dated October 2011 (see also item 31 on the Matrix provided by the CA BOE on January 17, 2012).

Part A: During the January Interested Parties Meeting the CA BOE took the position that in order to establish the full cash value (market value) of an active solar energy system a triggering event occurs; specifically the asset is exposed for sale. It was further stated that the exposure to the market implies a change of ownership and removes the exclusion from the active solar energy system. This position causes excluded assets to be viewed as taxable when conducting a decline in value analysis.

Please explain how a hypothetical sale of the active solar energy system represents a triggering event that causes the loss of the granted exclusion.

This Space Intentionally Left Blank

Part B: During the January 26, 2012 meeting the CA BOE commented on the appraisal unit concept, and suggested that the active solar energy system could not be segregated into separate fixtures during a decline in value analysis. As part of the example presented in our earlier comments (see below), base year values were established for two assets that are distinguished from one another. One asset was excluded and the other deemed taxable, each asset having its own distinct value while being a component of the same active solar energy system.

However, in subsequent appraisal periods the CA BOE's current position assumes the assets are indistinguishable from each other and hence are treated as one appraisal unit. In the case of active solar energy systems very specific parts have been segregated and categorized as non-excluded. These parts are segregated and considered non-excluded because they can be identified and valued separately from the rest of the solar energy system. Time does not change the identification of the assets as separate from the remaining system, nor does it change the ability to separately value these components of the active solar energy system.

If the active solar energy system represents a fixture that cannot be divided then why would separate assets be recognized as excluded or non-excluded during the base year assessment?

Please explain why separate recognition standards are applicable to the year in which the assets are placed in service versus the year when a decline in value analysis is warranted for the non-excluded assets.

Part C: We respectfully present the following example for discussion during the next meeting of interested parties.

A taxpayer has a home (non-excluded asset) worth \$500,000 in the base year and has installed a \$100,000 active solar energy system. The base year value for the non-excluded asset is \$500,000 because the active solar energy system is excluded. The taxpayer owns the assets for 10 years with no change in ownership and never places it on the market to be sold. This fact pattern implies that no triggering event has occurred and the exclusion of the active solar energy system is still in place.

In year 10 the asset has a factored base year value of \$609,500 (assuming a 2% increase per year). In that same year the taxpayer's full cash value of the non-excluded asset and the active solar energy system is \$620,000 (non-excluded value of \$570,000 and active solar energy system value of \$50,000). By current comparison standards the \$620,000 full cash value would be compared to the \$609,500 factored base year value. The lower of these values would be the assessed value to the taxpayer which in this case would be \$609,500.

The result of the above scenario is the assessment of an excluded asset in the amount of \$39,500 [calculated by subtracting the factored base year value of \$609,500 from the full cash value of the taxable asset of \$570,000]. By including the full cash value of the excluded asset (e.g. \$50,000 for the active solar energy system) into the full cash value of the "appraisal unit" the factored base year value is artificially lower than the value of the non-excluded asset on a standalone basis. This causes the

property owner to pay tax on an asset that should remain excluded due to the fact that no triggering event has occurred.

The below example was presented in our previous comments, and is included for reference purposes only.

Proposed Example

A property owner installs a qualified active solar energy system for \$100 million dollars (also considered the base year value for this example). In this instance, the system includes auxiliary equipment that is considered non-solar and is not excluded under the current interpretation of the Draft Guidelines. A value of \$5 million will be placed on the part of the solar facility that is not considered to be eligible for the exclusion. So, in this example we have \$95 million of the original cost being excluded from assessment as “new construction” and \$5 million of “new construction” not excluded. Five years from this point, the property owner still owns 100% of the property and is still operating it as an active solar energy system. At the lien date five years into the future, the county assessor reviews the property for a possible decline in value under Proposition 8.

The Draft Guidelines compare the factored base year value with the current market value, assuming no exclusions. According to the example provided “the county assessor would include the current market value of the active solar system in the current market value for the entire property. The current market value for the entire property would be compared to the enrolled value factored base year value, and the lesser of the two values enrolled” (Draft Guidelines; page 12, lines 3-6).

Using the fact pattern outlined above, we have conducted the following Decline in Value Test.

Step 1: When calculating the current market value according to the Draft Guidelines the assessors should value the active solar energy system as if it were available for sale on the open market. The current market value should include both excluded and non-excluded assets, as if the entire active solar energy system were made available for sale. As typical with most manufacturing businesses, the market values of active solar energy systems and other electrical plants are impacted by declines in output capabilities, market demand, prices of good produced (e.g. electricity), and other economic and/or obsolescence factors. The market value of an active solar energy system will fluctuate over time with a general downward trend as the facility ages. Assuming that the market value of the active solar energy system is estimated to be \$100 million less 5 years of depreciation of \$17 million, the plant’s estimated current market value is \$83 million. Then 5% of the current market value is allocated to the non-excluded assets which are equal to \approx \$4.2 million.

Step 2: For comparative values, the factored base year value is calculated as \$100 million plus a 2%¹ increase per year over 5 years or \approx \$110.4 million. Then 5% ² of the factored base year value is allocated to the non-excluded assets which are equal to \approx \$5.5 million.

¹ For simplicity, we are assuming that the factor used to estimate factored base year value is 2% per year.

² When the assets were placed in service 95% were excluded and 5% were non-excluded. This example assumes that this allocation of value will remain constant throughout the life of the assets for ad valorem tax purposes.

Comparison: The Draft Guidelines state that the assessed value should be the lower of the two values generated by the factored base year and current market value calculations. As can be seen above, Step 1 generated a value of ≈ \$4.2 million for the non-excluded assets and Step 2 generated a value of ≈ \$5.5 million for the non-excluded assets. The total assessed value for the non-excluded assets should be \$4.2 million. See illustration below.

Proposed Example as described above

Asset Value at Construction	\$100 Million
<i>Excluded New Construction</i>	<i>\$95 Million</i>
<i>Non-excluded New Construction</i>	<i>\$5 Million</i>
<hr/>	
Calculated Values (at year 5):	
Current Market Value	\$83.3 Million
<i>Excluded New Construction</i>	<i>\$79.1 Million</i>
<i>Non-excluded New Construction</i>	<i>\$4.2 Million</i>
<i>Assumes depreciation on the solar energy system as solar plants more closely resembles personal property and typically decline in value over time</i>	
Factored Base Year Value	\$110.4 Million
<i>Excluded New Construction</i>	<i>\$104.9 Million</i>
<i>Non-excluded New Construction</i>	<i>\$5.5 Million</i>
<i>Assumes a 2% annual increase for calculating the factored base year value of the \$100 million asset at year 5</i>	
<hr/>	
Comparison (at year 5):	
Current Market Value	\$4.2 Million
Factored Base Year Value	\$5.5 Million
Assessed Value	\$4.2 Million

Observations of Current Practice: Based on the lack of detailed guidance provided by the Board of Equalization (BOE) both on an historical and more current basis, many assessors are comparing the factored base year values of the non-excluded assets to the current market value of the entire active solar energy system. Logic would dictate that in order to achieve comparability between Step 1 (current market value) and Step 2 (the factored base year value); assessors should allocate the calculated values to the non-excluded assets. See illustration below which displays what the comparison looks like when the calculated values are not properly allocated to the non-excluded assets.

Observation of Assessor Methodology

Asset Value at Construction	\$100 Million
<i>Excluded New Construction</i>	<i>\$95 Million</i>
<i>Non-excluded New Construction</i>	<i>\$5 Million</i>
<hr/>	
Calculated Values (at year 5):	
Current Market Value	\$83.3 Million
Factored Base Year Value	\$110.4 Million
<i>Excluded New Construction</i>	<i>\$104.9 Million</i>
<i>Non-excluded New Construction</i>	<i>\$5.5 Million</i>
<i>Assumes a 2% annual increase for calculating the factored base year value of the \$100 million asset at year 5</i>	
<hr/>	
Comparison (at year 5):	
Current Market Value	\$83.3 Million
Factored Base Year Value	\$5.5 Million
Assessed Value	\$5.5 Million

Without further clarification of the guidance provided to date, including the underdeveloped example in the Draft Guidelines regarding the interaction between the factored base year value and current market value, there is too much room left for open interpretation and lack of consistency in the application of a decline in value test.