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July 3, 2008

TO STATE-ASSESSED TELECOMMUNICATION COMPANIES,
COUNTY ASSESSORS, AND
OTHER INTERESTED PARTIES:

OBSOLESCENCE FOR EQUIPMENT OF
STATE-ASSESSED TELECOMMUNICATION COMPANIES

The Board of Equalization will hold an interested parties meeting on July 22, 2008 on methods for supporting telecommunication equipment obsolescence. The meeting will be held at the Board's headquarters in Sacramento in Room 122, from 9:30 a.m. to 12:00 noon.

On February 20, 2008, a discussion paper was sent to state-assessed telecommunication companies, county assessors, and other interested parties titled *Obsolescence For Equipment of State-Assessed Telecommunication Companies* (posted on the Board's website at <http://www.boe.ca.gov/proptaxes/obsolequip.htm>). Interested parties were asked to submit comments or suggestions to issues presented in the discussion paper. The ultimate goal of this project is to determine the appropriate treatment of obsolescence for equipment of state-assessed telecommunication companies.

Staff received two responses after the discussion paper was distributed. Based on these and other responses and issues outlined in the discussion paper, staff has developed a matrix of general issues for discussion at the July 22 meeting. The general issues included on the enclosed matrix also consider issues raised in the 2006 and 2007 unitary appraisals and appeals processes for telecommunication companies.

Staff notes that while most of the issues raised relate to telecommunication equipment obsolescence, only a very limited number of the issues were raised by more than one company. In developing the general issues, if an issue is company-specific, staff has addressed it as an industry issue, with the assumption that it has more general application.

If you plan to attend the July 22 meeting, please advise Ms Sherrie Kinkle at sherrie.kinkle@boe.ca.gov or at 916-322-2921.

Sincerely,

/s/ Donald L. Jackson

Donald L. Jackson, Acting Chief
State-Assessed Properties Division

DJ:sk
Enclosure

**OBSOLESCENCE FOR EQUIPMENT OF STATE-ASSESSED TELECOMMUNICATION COMPANIES
MATRIX OF GENERAL ISSUES FOR DISCUSSION**

No.	GENERAL ISSUE	SAPD STAFF POSITION
1.	Can obsolescence measured by comparing investment or shareholder returns of companies provide some insight into the economics and valuation of assessable tangible property?	These return figures more appropriately reflect the value of the business. As a sole measure, investment or shareholder returns of companies is not a reliable measure to determine the value of the unit when the unit being measured is materially different than the company value. Other factors can contribute positively or negatively to the business, such as labor, management, and intangibles, including trade names, franchises, contracts, etc.
2.	Can obsolescence measured by a comparing return on investment of a specific industry to a market return for all industries provide some insight into the economics of assessable tangible property?	This type of comparison is not the best approach to use to measure obsolescence because each industry has its own risk element. A gas and electric company, for example, does not have the same risk element as a telephone company. Similarly, a Fortune 500 company does not have the same risk element as a regional telephone company. Rather, a more appropriate method to measure obsolescence is to compare returns on properties of similarly situated companies in the same industry.
3.	Functional obsolescence is sometimes measured by comparing physical life versus functional life. If there is functional obsolescence, it will be indicated with a shorter life estimate. Thus, the difference in value when calculating a property's obsolescence using a physical-versus-functional life will result in an obsolescence adjustment.	The concern with any such calculation, however, is how the lives are determined and what evidence is used to determine those lives. There must be adequate support, not just to show that the functional life is shorter than the physical life, but also to show that the functional life is based on factual evidence and not based upon perceptions and anecdotal evidence.
4.	Accounting standards, such as FASB Statements 141 and 144, require a company to write-down its assets (when applicable) to adequately recognize or account for loss in value of those assets.	<p>Write-downs of these types may not fully recognize all the obsolescence in the assessable property. The amount of additional obsolescence to be recognized should not be as material after a company has taken a recent FASB 144 impairment as part of its financial statement reporting or after an FASB 141 purchase price allocation adjustment has been made.</p> <p>Note: Care should be taken in considering a FASB 141 or 144 write-down to ensure it reflects the value of all costs necessary to put the property into beneficial and productive use.</p>

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No.	GENERAL ISSUE	SAPD STAFF POSITION
5.	Estimating obsolescence by considering the principle of substitution can be useful.	Where there is valid support or documentation as to the proper substitute, a reliable estimate can be made of the amount of obsolescence that a property has suffered. The support or documentation should come from both the property owner and other independently verifiable sources within the telecommunications industry.
6.	Can trend lines be the basis for an obsolescence adjustment?	Trend lines tend to have a margin of error. More importantly, the trend should not be based on perceptions alone. Any trend line analysis must be evaluated to determine whether the level of reliability and predictability is adequate.
7.	Percent good factors based on average remaining life (ARL) of a particular class of property take into account how a property will be replaced by the adoption of new technology. The ARL is impacted by the severity of competition within the industry.	The main concern with using ARL as presented by certain companies is that the ARL does not take into account a company's actual or planned investment and the type of investment required to remain competitive. Thus, ARL should not be based only on the effects of competition and technology in the industry without consideration of the mitigating effect of actual investment history or planned investment. An example of this where one company installs all fiber in its network while another company installs a combination of equipment with less fiber. Both plant investment approaches are equally valid and enable the companies to stay competitive.
8.	Board guidelines should differentiate between remaining economic life and average remaining life.	Staff will consider incorporating such information if relevant.
9.	The inutility model relies on proper measurement of standard capacity. Inutility generally measures the difference between theoretical or practical capacity versus actual production. The inutility model is best known for its use in measuring differences in operating levels for production or manufacturing facilities. The use of the inutility model in measuring operating differences for non-production properties can be problematic.	Staff has not been able to review sufficient inutility data or other information to determine if inutility models are proper for use in determining telecommunication equipment obsolescence. As well, determining accurate practical capacity and actual performance levels for telecommunication properties can be difficult.

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10.	Per unit replacement value. As in a sales comparison approach that is based on square footage for land or buildings, consideration of a per unit approach for valuing telecommunication property could be an option, if feasible.	<p>The following are a few issues that need to be addressed when considering a unit of comparison approach.</p> <ul style="list-style-type: none"> • Finding a common comparable unit across all telecommunication equipment categories, considering the fact the telecommunication equipment can vary greatly and that technology change is not static. • A per unit value must represent all costs necessary to put the property into service including engineering, installation, and peripheral costs. • A per unit value must be reflective of a comparable telecommunication system, including all necessary components that are capable of delivering the telephone services provided by the subject company.
11.	Board guidelines should show how ordinary and extraordinary obsolescence are reflected in the Board's replacement cost models.	This information is provided in the Board's Valuation Methods Book.
12.	Board guidelines should thoroughly address cost to cure and inutility methodologies.	Various appraisal texts address these and other methodologies. Staff will consider incorporating such information if relevant.

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13.	<p>When claiming obsolescence there is a need to identify the issues involved, the measurement methods used, and to provide documentation and evidence to support claims. Studies, analyses, and/or statements of fact for claiming obsolescence should be substantiated with verifiable evidence to enable staff to make an informed judgment concerning the proper value to be ascribed to the property being assessed.</p> <p>Such documentation may include, but is not limited to, the following:</p> <ol style="list-style-type: none"> 1. Financial information including: <ol style="list-style-type: none"> a. Audited financial statements b. FASB 144 Impairment Studies c. FASB 141 Purchase Price Allocation Studies d. Statement of Position (SOP) 90-7 Analysis, Bankruptcy 2. Analyses, Studies, and Reports (accompanied by verifiable evidence): <ol style="list-style-type: none"> a. Replacement cost b. Economic life c. Income shortfall d. Inutility e. Return on investment 	<p>In determining the amount of obsolescence present in these properties, staff considers methods that are based on supportable data and information. More than one method can be considered and/or used to add validity to the results. The methods should yield consistent results. Results that are inconsistent with each other should be analyzed and reconciled carefully before given any meaningful consideration.</p>