Issue Paper Number **02-023**

- ☐ Board Meeting
- ☐ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☒ Property Tax Committee
- ☐ Other

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

GUIDELINES FOR THE ASSESSMENT OF BILLBOARDS

I. Issue

Should the Board adopt guidelines for the assessment of billboard properties to clarify, among other things, that:

1. In applying the income approach to value, operating income may be used in estimating the income to be capitalized?
2. The presence of a special use permit to operate a billboard may properly contribute to a fair market value assessment of the billboard property?

II. Staff Recommendation

Staff recommends that the Board adopt guidelines for the assessment of billboard properties to include clarification that, under certain circumstances: (1) it may be appropriate for the assessor, in applying the income approach to value, to use operating income estimating the income to be capitalized; and (2) the presence of a special use permit may contribute to the fair market value of billboard properties. (Attachment A.)

III. Other Alternative(s) Considered

1. The Board could adopt guidelines to advise that in applying the income approach, operating income should not be used to estimate the income to be capitalized when determining fair market value for billboard properties. (Attachment B.)
2. The Board could adopt guidelines to advise that the recognition of value attributable to a special use permit is prohibited when assessing billboard properties. (Attachment C.)

Issue Paper Number 02-023

IV. Background

Billboards present an appraiser with several apparent contradictions. For example, while billboards are typically purchased for their capacity to generate income, it may be difficult to identify the income that is attributable to the taxable property. Further, while the demand for authorized billboard sites suggests that such sites are quite valuable, this notion may be challenged by the fact that much of their value arises from the presence of special use permits that, while necessary for the billboard use, are an intangible (and thus nontaxable) species of property.

The unusual character of billboard properties is a source of disagreement over the proper method of assessing them, and actual practices vary among county assessors. To resolve the disagreement and promote uniform assessment practices, the Board instructed staff to work with interested parties to develop guidelines for assessors and tax practitioners statewide.

In September, staff published draft guidelines and held a meeting of interested parties to discuss the draft. Negotiations between staff and industry resulted in agreement as to the proper classification of billboards and the method of valuing the billboard improvement. County assessors brought no organized representation to the discussions.

Despite this common ground, two issues remain unresolved. The first is whether an assessor, in applying the income approach to value, may use earnings from the business operating a billboard. The second issue involves the treatment of the nontaxable intangible special use permits that are necessary to the operation of a billboard.[1] Concepts underlying these issues are discussed below.

Use of Operating Income

The basis of the income approach is that the value of income-producing property can be estimated by converting (i.e., capitalizing) future income anticipated by investors into a figure that represents present value. For properties that are typically rented, the future income is estimated directly from recently negotiated rents for similar properties. For properties that are not typically rented, but which nevertheless generate income through their operation, the future income may be estimated indirectly from earnings of the *business* operating the property.

Property Tax Rule 8 provides that income derived from the rental of properties is preferred to income derived from their operation, since income derived from operations is more likely to be influenced by managerial skills and may arise in part from nontaxable property or other sources. The rule provides further that, when income from operating a property *is* used, sufficient income must be excluded to account for nontaxable operating assets and to compensate for unpaid or underpaid management.[2]

The decision of whether to estimate future income from operating earnings involves an evaluation of the extent to which those earnings are generated through the use of the taxable property. If the earnings are generated principally from enterprise activity (i.e., the sale of goods or services) rather than from the use

[1] As a practical matter, neither of these issues will arise unless there is a change in ownership of the land underlying the billboard improvement.
[2] Property Tax Rule 8, subsection (e).

of taxable property, then those earnings will bear little relevance to the value of the business's taxable property.[3]

Whether the earnings of a billboard operator are generated through the use of taxable property is a source of some debate. For example, while industry has argued that a billboard operator's earnings are ascribable to the sale of advertising (i.e., a service), staff's position is that those earnings derive principally from the billboard operator's ability to "rent" to advertisers the right to display messages on a billboard (i.e., an item of taxable property).

Treatment of Intangible Special Use Permits

A general rule under California property tax law provides that the value of intangible property relating to the activities of a business may not enhance or be reflected in the value of the business's taxable property.[4] A corollary to this general rule provides that, if a group of assets composed of both taxable property and nontaxable intangible property is valued as a unit, then the value of the taxable property must be determined by removing the value of the nontaxable intangible property.[5]

An exception to this general rule occurs where otherwise nontaxable intangible assets are necessary for the beneficial or productive use of taxable property. In that event, the value of the taxable property is determined assuming the presence of the necessary intangible assets, and the intangible assets may properly contribute to a fair market value assessment of the taxable property.[6]

In valuing taxable property of a business that holds valuable intangible assets, an appraiser must consider the purpose of the intangible assets. For example, a retail clothing business may have designed customer service training methods that, collectively, constitute a valuable intangible asset. Since the purpose of such an intangible asset is to promote the success of the business, and not to enable the use of taxable property, it would be logical to conclude that the training methods do not contribute to the value of the business's taxable property.[7]

By contrast, if the purpose of an intangible asset is to enable the profitable use of taxable property, the intangible asset may properly contribute to a fair market value assessment of that property.[8] Government permits that authorize the use of taxable property for specific purposes represent such intangible assets, and their presence should be assumed in the valuation of the taxable property with which they are associated.[9]

Attachment A is staff's draft of guidelines for the assessment of billboards. Industry and staff have agreed on much of the language in the draft. Attachment B shows, in the form of industry's proposed alternative text, the areas where industry and staff remain in disagreement regarding the issue of using operating income in estimating the income to be capitalized. Attachment C shows industry's proposed alternative text regarding whether special use permits contribute to the fair market value assessment of billboard properties.

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[3] Assessors' Handbook Section 502 (AH 502), p. 160.
[4] Revenue and Taxation Code section 110(a).
[5] Revenue and Taxation Code section 110(d)(2).
[6] Revenue and Taxation Code section 110(e); *American Sheds, Inc.* v. *County of Los Angeles* (1998) 66 Cal.App.4th 384.
[7] AH 502, p. 154.
[8] *American Sheds, Inc. v. County of Los Angeles* (1998) 66 Cal.App.4th 384.
[9] AH 502, *supra*.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff's draft would provide guidelines that (1) sanction the use of operating income in the appraisal of billboard properties and (2) give recognition to the notion that the presence of a special use permit to operate a billboard may properly contribute to a fair market value assessment of the billboard site.

B. Pros of the Staff Recommendation

- Staff's draft recognizes an assessor's lawful discretion to apply any of the traditional approaches to value, including an income approach based on the capitalization of net earnings derived from the operation of taxable property.[10]
- Staff's draft provides guidance that is consistent with current law governing the treatment of intangible special use permits.

C. Cons of the Staff Recommendation

- According to industry, staff's draft is practically flawed in sanctioning the use of operating income from a billboard property. Specifically, industry has argued that the use of such operating income is "disfavored because of the difficulty in making the deductions necessary to identify the discrete income stream for the taxable property only."
- Under industry's view, staff's draft would contradict current law governing the treatment of intangible assets. Industry asserts, in essence, that staff's draft fails to ensure the exclusion from assessment of any and all value attributable to the intangible special use permit required to operate a billboard.

D. Statutory or Regulatory Change

None.

E. Administrative Impact

Minimal. Completion of the project will require an expenditure of staff time for the distribution of the assessment guidelines.

F. Fiscal Impact

1. Cost Impact

No additional cost. The workload associated with developing and distributing the assessment guidelines is considered routine and any corresponding cost would be within the existing budgeted base.

2. Revenue Impact

Minimal. See attached revenue estimate.

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[10] *De Luz Homes, Inc.* v. *County of San Diego* 45 Cal.2d 546.

G. Taxpayer/Customer Impact

Assessors and tax practitioners would be provided with uniform guidance on the assessment of billboard properties.

H. Critical Time Frames

In order for guidelines on the assessment of billboard properties to be available for the 2003 lien date, the Board should adopt language at its November 2002 meeting.

VI. Alternative 1

A. Description of the Alternative

The proposed alternative text provided by industry would:

1. Effectively bar an income approach that makes use of the earnings of the business operating a billboard property. (Attachment B.)

2. Result in guidelines that emphasize the exclusion of all value attributable to the intangible special use permit necessary for the operation of a billboard. (Attachment C.)

B. Pros of the Alternative

1. According to industry, their alternative text would recognize the practical difficulty in using an income approach that relies on earnings from the operation of a billboard property.

2. According to industry, their alternative text would be consistent with current law governing the treatment of intangible assets. Specifically, industry asserts their alternative text would properly ensure the exclusion from assessment of any and all value attributable to the special use permit necessary to the operation of a billboard property.

C. Cons of the Alternative

- Industry's alternative text fails to recognize an assessor's lawful discretion to apply any of the traditional approaches to value, including an income approach based on the capitalization of net earnings derived from the operation of taxable property.

- Industry's alternative text presumes facts about billboard properties that have yet to be demonstrated. While industry's proposal would bar the use of operating income, industry has failed to provide data that would enable staff or assessors to independently evaluate the claim that it would be too difficult for assessors to make the appropriate adjustments under Rule 8. Thus, industry would have the Board recommend special treatment for billboard property without factual justification.

- Industry's alternative text would result in guidance that contradicts current law governing the treatment of intangible special use permits. Specifically, industry's proposal would advise assessors to value a billboard property not assuming the presence of the special use permits necessary for the billboard operation, but rather as though those permits were nonexistent.

D. Statutory or Regulatory Change

None.

E. Administrative Impact

Minimal. Completion of the project will require an expenditure of staff time for the distribution of the assessment guidelines.

F. Fiscal Impact

1. Cost Impact

No additional cost. The workload associated with developing and distributing the assessment guidelines is considered routine and any corresponding cost would be within the existing budgeted base.

2. Revenue Impact

Minimal. See attached revenue estimate.

G. Taxpayer/Customer Impact

Assessors and tax practitioners would be provided with uniform guidance on the assessment of billboard properties.

H. Critical Time Frames

In order for guidelines on the assessment of billboard properties to be available for the 2003 lien date, the Board should adopt language at its November 2002 meeting.

Prepared by: Property and Special Taxes Department; Assessment Policy and Standards Division
Legal Department; Property Taxes Section

Current as of: October 30, 2002

STAFF RECOMMENDED LANGUAGE

ASSESSMENT OF BILLBOARD PROPERTIES

DESCRIPTION OF BILLBOARDS

Billboards, or off-premise outdoor advertising signs, make advertising space available to advertisers for display to the public. These signs do not advertise the business or other activity occurring at the site on which the billboard is located. The larger and most common types of billboards are usually located on leased property adjacent to freeways, highways and other major thoroughfares.

Almost all billboards are owned by billboard companies. Billboard companies offer display space on their billboards to advertisers for a fee. The billboard companies also place and remove the advertisements and may design and produce the advertising copy, although this function is usually performed by the advertiser's advertising agency.

Advertising space is often marketed for a group of billboards rather than for a single billboard. These group sales are called "showings." Billboard companies know approximately how many people see each of their billboards each day and their demographic attributes. Using this information, the companies are able to configure their billboard inventories into showings that provide a specified level of advertising exposure for various advertisers' target markets.

A billboard is essentially a frame supported by a pole (or poles), to which a display panel is attached on one or both sides. Sometimes a billboard is mounted to a building or other structure rather than being free standing. Almost all newly constructed billboards are made of steel and are designed to modern engineering standards. They are structurally secured to the land on a permanent foundation.

Billboards come in four standard configurations: "juniors" (standard panel size 6 x 12 feet); "posters" (standard panel size 12 x 25 feet); "bulletins" (standard panel size 14 x 48 feet, sometimes slightly smaller); and "spectaculars" (billboards built to order, with unique shapes and features, typically as large or larger than bulletins).

The billboard site—that is, the land on which the billboard is situated—is generally limited to an area large enough to accommodate the billboard's foundation and to allow for service and maintenance of the billboard. As noted above, the billboard owner generally holds a leasehold interest in the billboard site; fee simple ownership in the billboard site is usually held by an unrelated party that owns the land contiguous to the billboard site.

CLASSIFICATION OF BILLBOARDS

Billboards are properly classified as fixtures under Property Tax Rule 122.5(a)(1), which defines a fixture to include an item of tangible property which is "physically or constructively annexed to realty with the intent that it remain annexed indefinitely." In general, billboards are affixed to the ground, are moved infrequently, and are intended to remain annexed until the leasehold interest in the land terminates. These circumstances require that billboards be classified as fixtures.

BILLBOARD PROPERTY COMPONENTS AND APPRAISAL UNIT

The appraisal unit refers to the nature and extent of the property being valued. For property tax purposes, unless the law specifically provides otherwise, the appraisal unit is the unit of property commonly bought and sold.[1]

The sale of a billboard property normally includes the following: (1) the *billboard improvement* (i.e., the sign and its foundation); (2) the *billboard use permit (or permits)*, which allows the billboard owner to construct and operate the billboard; and (3) the *leasehold interest* in the land, or billboard site. These three elements constitute the billboard appraisal unit, designated here as the *billboard property*. The ground lessor's interest in the billboard site (i.e., the interest held by the fee owner of the billboard site) is a separate appraisal unit.

APPROACHES TO VALUE

Where the entire billboard property is subject to reassessment, then any of the three generally accepted approaches to value may be used.[2] Discussed briefly below are the cost approach, the comparative sales approach (using a gross income multiplier, or "GIM"), and the income approach, using direct capitalization with a sales-derived overall capitalization rate.[3]

However, as a practical matter, the appraiser will in most cases be valuing the billboard improvement in isolation using the cost approach. The land (i.e., the leasehold interest in the billboard site) would generally be subject to reassessment only upon a transfer of the lessor's interest. Thus, in most cases the appraiser will have no need to request either income data from

[1] See Revenue and Taxation Code section 51(e); Property Tax Rule 324; and Assessors Handbook Section 502 (AH 502) (December 1998), pp. 2-5.

[2] For additional information concerning the approaches to value generally, see AH 501, AH 502, or a general appraisal text. As provided in Property Tax Rules 4, 6 and 8, one approach to value may be preferred over other approaches if reliable data necessary for applying the other approaches to value is not available or when certain factors make the other approaches less reliable.

[3] Where the entire billboard property is subject to reassessment, assessors may rely upon the same authorities for gathering relevant assessment data about billboard properties as are relied upon for other types of property. Such authorities include the general requirement, under section 441 of the Revenue and Taxation Code, that persons make available to the assessor information or records regarding his or her property.

With respect to billboard properties, the assessor may request a timely filed property statement (Form 571L) showing all taxable billboard property, including its location and description, that is owned, claimed, possessed, controlled, or managed by the company.

the billboard operator or lease data from the landowner in order to develop an indicator of value under either the income or comparative sales approaches.

COST APPROACH

Applying the cost approach to a billboard property involves the following steps:

1. Estimate the cost new of constructing and siting the billboard improvement.
2. Estimate the depreciation incurred by the billboard improvement.[4]
3. Subtract the estimated depreciation from the cost new to arrive at the depreciated cost of the billboard improvement.
4. Estimate the value of the leasehold interest in the billboard site held by the billboard company.
5. Add the value of the leasehold interest in the billboard site to the cost new less depreciation of the billboard improvement to arrive at a value indicator for the billboard property.[5]

The estimated cost new should reflect the full economic cost of creating the substitute billboard improvement, comprising direct ("hard") costs, indirect ("soft") costs, and entrepreneurial profit.[6] Cost data may be obtained from property statements filed by billboard companies or from contractors who construct billboard improvements.

In all approaches, the value of intangible assets and rights must be excluded from the final value indicator for the taxable property. In general, this adjustment is unnecessary in the cost approach because in that approach intangible assets and rights typically are not included as components of the appraisal unit.[7]

COMPARATIVE SALES APPROACH—GROSS INCOME MULTIPLIER

In direct sales comparison, a value indicator is developed by comparing a comparable property to the subject property and adjusting the sale price of the comparable property for differences between it and the subject.[8] Billboard properties, however, typically sell in groups, and there is little data regarding sales of individual billboard properties. This makes it difficult to apply direct sales comparison to billboard properties.

[4] As with other improvements, billboards are subject to three forms of depreciation, or loss in value: physical deterioration, functional obsolescence, and external obsolescence. In typical practice, the depreciation of a billboard improvement is estimated using age-life depreciation, or percent-good tables. AH 581 contains tables of index and percent good factors for various types of fixtures. It is recommended that Table 1 ("Commercial Equipment Index Factors") and Table 4 ("Machinery and Equipment Percent Good Factors") from AH 581 be used to estimate cost new less normal depreciation.

[5] Steps 4 and 5 are necessary only when the land has undergone a change in ownership pursuant to the provisions of subdivision (c)(1) of Revenue and taxation Code section 61 and Property Tax rule 462.100, subsections (a)(1) and (a)(2).

[6] Revenue and Taxation Code section 401.6 requires market-derived evidence of entrepreneurial profit when the cost approach is used to value special use property.

[7] AH 502, p. 159, n. 126.

[8] See Revenue and Taxation Code section 402.5; Property Tax Rule 4; and AH 502, Chapter 3. In the case of a billboard property, if the ground lease does not reflect market rent, it is also necessary to adjust the comparable sales data for this element.

Since sales of individual billboard properties rarely occur, it may be more practicable to use a gross income multiplier (GIM) derived from a sale of a group of billboard properties. The GIM method is commonly used within the billboard industry as a means of evaluating purchases and sales of billboard properties.

To derive an EGIM, the sale price of a comparable billboard property (or group of billboard properties) is converted into a multiple of the subject's annual anticipated effective gross advertising income (i.e., gross advertising income less allowances for vacancy [periods when the billboard space is not rented] and advertising agency commissions). To generate a value indicator for the subject billboard property (or group of billboard properties), the derived multiplier is multiplied by the subject billboard property's expected annual effective gross income.

With a group sale, the estimated value for the group being appraised can be allocated to the separate billboard properties in the group using a generally accepted measure of productivity for a billboard property such as average Daily Effective Circulation (DEC).[9] An income multiplier derived from a group sale can also be adjusted such that it can be applied to an individual billboard property.

Gross income multipliers should be used only when the reported sale is very similar to the subject billboard property, and the reported sale must be adjusted in order to make it closely comparable to the subject billboard property in terms of income potential, expense ratios, location and physical characteristics.[10]

The derived income multiplier should be based on the taxable value of the billboard property (or properties) only. Thus, when deriving an income multiplier the following adjustments should be made to the reported sale price, as applicable:

- Convert any noncash consideration accepted by the seller as all or part of the purchase price to its cash equivalent amount.
- Remove the estimated value of any real property included in the sale that is not part of the billboard plant (i.e., billboard properties) from the reported sale price (e.g., an office building or shop/maintenance facility).
- Remove the estimated value of any personal property included in the sale from the reported sale price (e.g., equipment, furnishings, automobiles).
- Remove the estimated value of any intangible assets or rights (i.e., use permit value and enterprise value) included in the sale from the reported sale price.

[9] Daily Effective Circulation (DEC) is a statistical measurement of a billboard's traffic volume, or exposure. The Traffic Audit Bureau provides independent, audited DEC information for all billboards entered into its system. The information is used by both billboard companies and advertisers.

[10] AH 502, p. 81; Property Tax Rule 8, subsection (h).

INCOME APPROACH—DIRECT CAPITALIZATION

In the income approach, rental income is preferred to operating income, since operating income may be attributable, in part, to nontaxable property or other sources. There are several types of income associated with billboard properties, including income from the lease of a billboard improvement to a billboard operator (this rarely occurs). Since rental income is typically unavailable, however, operating income is often used. With operating income, an income attributable to the billboard property (or group of billboard properties) is imputed by taking the expected total advertising income generated by the subject billboard property (or group of billboard properties), excluding any amount of income that derives from nontaxable sources (such as the billboard use permit and any other elements of enterprise value), and further deducting all allowed expenses (i.e., items of "gross outgo" in Property Tax Rule 8(c)).

Once the anticipated future income is estimated, appropriate deductions for vacancy and collection loss, commissions to advertising agencies, and operating expenses are made to arrive at net income. Operating expenses include painting and production (poster installation), maintenance, electricity, management, insurance, and recurring permit fees (not use permit fees).

After net income is determined, an appropriate capitalization rate must be developed. An overall capitalization rate can be derived from a sale of a comparable billboard property (or group of comparable billboard properties). The rate is then applied to the subject billboard property (or group of billboard properties) to generate the value indicator. Again, the value indicator for a group of billboard properties can be allocated to the separate properties within the group using a generally accepted measure of a billboard property's utility, such as Daily Effective Circulation.

INTANGIBLE ASSETS AND RIGHTS

The siting, construction, and operation of billboard properties is regulated by the Outdoor Advertising Act and/or by county or municipal ordinances.[11] The Outdoor Advertising Act or these local laws (or both in some instances) control the issuance of billboard use permits. State and local governments have used these laws to limit the number of billboards in many areas. By regulating (i.e., limiting) the number of billboard use permits, government has increased the value of existing billboard properties. The value resulting from the scarcity of billboard use permits should be attributed to the use permits and not to the billboard improvements.

The billboard use permit is an intangible asset or right under Revenue and Taxation Code section 110(e) that is necessary for the beneficial and productive use of the billboard property. Since the use permit is an intangible asset or right that is not itself assessable, any increment of value attributable to the use permit must not be included in the taxable value of the billboard property.[12] However, since a billboard use permit is necessary to put the land to beneficial and

[11] In regard to the Outdoor Advertising Act, see Business and Professions Code section 5200, et seq.
[12] AH-502, pp. 152, 163.

productive use as a billboard site, the land must be assessed and valued by assuming the presence of the use permit.[13]

In addition to the billboard use permit, intangible assets or rights that may need to be considered for the purpose of removing any increment of value attributable thereto include relationships between a billboard company and advertisers or advertising agencies; assembled work force of a billboard company; the marketing activities associated with the ownership of multiple billboard properties (e.g., the ability to market billboard display space as "showings"); and company reputation, or "goodwill."

Location must be considered in assessing billboards. The impact of location on the income which a particular billboard generates, or the price at which that billboard sells, can be considerable. This impact results from the "traffic count" or "exposure" that a particular location provides. However, a higher traffic count has little or nothing to do with a particular billboard improvement, but derives from the land on which the billboard improvement is situated (i.e., location). In assessing the billboard property, the value attributable to location should be assigned to the land and not to the billboard improvement.

ALLOCATION OF VALUE TO BILLBOARD PROPERTY COMPONENTS

The value of the billboard property should be allocated between the land (i.e., the leasehold interest in the billboard site) and the billboard improvement in the following manner.

1. Estimate the value of the billboard property net of the value of non-taxable intangible assets and rights, including the value of the billboard use permit. This establishes the taxable value that is to be allocated.

2. Estimate the value of the billboard improvement based on its cost new less depreciation.

3. Subtract the estimated value of the billboard improvement from the value of the billboard property and allocate this remainder to the land. In other words, all value of the billboard property in excess of the billboard improvement's depreciated cost should be allocated to the land as a residual. This method of allocation is consistent with the billboard's classification as a fixture and its status as a separate appraisal unit.

The portion of the value of the billboard property that is allocated to the land may or may not be assessable depending on the terms of the ground lease. In order to reassess the value allocated to land, a change in ownership of the land under article XIII A ("Proposition 13") must have occurred.[14]

As discussed above, typically there are two interests in the billboard site: (1) the leased fee interest of the ground lessor (i.e., the interest held by the fee owner of the billboard site) and (2) the leasehold interest of the ground lessee (i.e., the interest held by the billboard company's

[13] See Revenue and Taxation Code section 110(e); AH 502, pp. 154-155.
[14] See subdivision (c)(1) of Revenue and Taxation Code section 61 and Property Tax Rule 462.100, subsections (a)(1) and (a)(2).

interest). Only the second interest, the leasehold interest in the billboard site, is part of the appraisal unit designated as the billboard property. The value of both interests in land, however, should be included in a single assessment to the owner of the fee interest in land. In other words, a separate land assessment should not be created for the billboard company's leasehold interest in the billboard site. (And as noted, any value attributable to the billboard company's leasehold interest in the billboard site only becomes assessable if there has been a change in ownership of the billboard site.)[15]

[15] Two other assessment issues concerning billboards should be briefly discussed. First, a number of billboard properties are located within railroad rights of way, raising the jurisdictional question of whether these properties should be state or locally assessed. In general, all property that is owned or used by a state assessee is assessed by the Board. As with other billboard properties, the entire value of the billboard site should be assessed to the fee owner of the billboard site, in this case, the state assessee. Thus, the only component of a billboard property that should be locally assessed is the billboard improvement. The second issue concerns billboard properties that are also taxable possessory interests. A billboard property that constitutes a taxable possessory interest should be valued as any other taxable possessory interest.

INDUSTRY RECOMMENDED LANGUAGE ON ISSUE NO. 1
USE OF OPERATING INCOME

BEGINNING ON PAGE 4, LINE 5, OF STAFF LANGUAGE

~~To derive an EGIM, the sale price of a comparable billboard property (or group of billboard properties) is converted into a multiple of the subject's annual anticipated effective gross advertising income (i.e., gross advertising income less allowances for vacancy [periods when the billboard space is not rented] and advertising agency commissions). To generate a value indicator for the subject billboard property (or group of billboard properties), the derived multiplier is multiplied by the subject billboard property's expected annual effective gross income.~~

~~With a group sale, the estimated value for the group being appraised can be allocated to the separate billboard properties in the group using a generally accepted measure of productivity for a billboard property such as average Daily Effective Circulation (DEC).[16] An income multiplier derived from a group sale can also be adjusted such that it can be applied to an individual billboard property.~~

In some instances, it may be possible to develop a GIM from a sale by dividing the sale price by the annual gross advertising income which a group of billboard properties generate. Using GIMs in the assessment of a billboard property, however, will produce excessive taxable values unless significant, and sometimes subjective, adjustments are made.[17] This occurs because GIMs are derived from the total advertising income generated by a group of assets which are often found in multiple counties, including non-billboard property and non-taxable assets (such as intangible billboard use permits). In addition, the advertising income generated by a group of billboard properties will usually include non-assessable "synergy" value which results from operating a group of billboards.

Gross income multipliers should be used only when the reported sale is very similar to the subject billboard property, and the reported sale must be adjusted in order to make it closely comparable to the subject billboard property in terms of income potential, expense ratios, location and physical characteristics.[18]

The derived income multiplier should be based on the taxable value of the billboard property (or properties) only. Thus, when deriving an income multiplier the following adjustments should be made to the reported sale price, as applicable:

- Convert any noncash consideration accepted by the seller as all or part of the purchase price to its cash equivalent amount.

~~[16] Daily Effective Circulation (DEC) is a statistical measurement of a billboard's traffic volume, or exposure. The Traffic Audit Bureau provides independent, audited DEC information for all billboards entered into its system. The information is used by both billboard companies and advertisers.~~

[17] AH 502, p. 160.

[18] AH 502, p. 81; Property Tax Rule 8, subsection (h).

- Remove the estimated value of any real property included in the sale that is not part of the billboard plant (i.e., billboard properties) from the reported sale price (e.g., an office building or shop/maintenance facility).
- Remove the estimated value of any personal property included in the sale from the reported sale price (e.g., equipment, furnishings, automobiles).
- Remove the estimated value of any intangible assets or rights (i.e., use permit value and enterprise value) included in the sale from the reported sale price.

INCOME APPROACH—DIRECT CAPITALIZATION

In the income approach, rental income is preferred to operating income, since operating income may be attributable, in part, to nontaxable property or other sources. There are several types of income associated with billboard properties, including income from the lease of a billboard improvement to a billboard operator (this rarely occurs). ~~Since rental income is typically unavailable, however, operating income is often used.~~ Billboard advertising income is equivalent to operating income and should not be used.[19]

~~With operating income, an income attributable to the billboard property (or group of billboard properties) is imputed by taking the expected total advertising income generated by the subject billboard property (or group of billboard properties), excluding any amount of income that derives from nontaxable sources (such as the billboard use permit and any other elements of enterprise value), and further deducting all allowed expenses (i.e., items of "gross outgo" in Property Tax Rule 8(c)).~~

Once the anticipated future income is estimated, appropriate deductions for vacancy and collection loss, commissions to advertising agencies, and operating expenses are made to arrive at net income. Operating expenses include painting and production (poster installation), maintenance, electricity, management, insurance, and recurring permit fees (not use permit fees).

After net income is determined, an appropriate capitalization rate must be developed. An overall capitalization rate can be derived from a sale of a comparable billboard property (or group of comparable billboard properties). The rate is then applied to the subject billboard property (or group of billboard properties) to generate the value indicator. ~~Again, the value indicator for a group of billboard properties can be allocated to the separate properties within the group using a generally accepted measure of a billboard property's utility, such as Daily Effective Circulation.~~

[19] Property Tax Rule 8, subsection (e). Although income attributable solely to taxable billboard property might be imputed by excluding income related to nontaxable operating assets, this technique is disfavored because of the difficulty in making the deductions necessary to identify the discrete income stream for the taxable property only. AH 502, pp. 162, 164.

INDUSTRY RECOMMENDED LANGUAGE ON ISSUE NO. 2 TREATMENT OF INTANGIBLE USE PERMITS

<u>BEGINNING ON PAGE 5, LINE 22, OF STAFF LANGUAGE</u>

INTANGIBLE ASSETS AND RIGHTS

The siting, construction, and operation of billboard properties is regulated by the Outdoor Advertising Act and/or by county or municipal ordinances.[20] The Outdoor Advertising Act or these local laws (or both in some instances) control the issuance of billboard use permits. State and local governments have used these laws to limit the number of billboards in many areas. By regulating (i.e., limiting) the number of billboard use permits, government has increased the value of existing billboard properties. The value resulting from the scarcity of billboard use permits should be attributed to the use permits and not to the billboard improvements.

The billboard use permit is an intangible asset or right under Revenue and Taxation Code section 110(e) that is necessary for the beneficial and productive use of the billboard property <u>and its presence must be assumed.</u> Since the use permit is an intangible asset or right that is not ~~itself~~ assessable, any increment of value attributable to the use permit must not be included in the taxable value of the billboard property.[21] ~~However, since a billboard use permit is necessary to put the land to beneficial and productive use as a billboard site, the land must be assessed and valued by assuming the presence of the use permit.~~ ~~[22]~~

In addition to the billboard use permit, intangible assets or rights that may need to be considered for the purpose of removing any increment of value attributable thereto include relationships between a billboard company and advertisers or advertising agencies; assembled work force of a billboard company; the marketing activities associated with the ownership of multiple billboard properties (e.g., the ability to market billboard display space as "showings"); and company reputation, or "goodwill."

Location must be considered in assessing billboards. The impact of location on the income which a particular billboard generates, or the price at which that billboard sells, can be considerable. This impact results from the "traffic count" or "exposure" that a particular location provides. However, a higher traffic count has little or nothing to do with a particular billboard improvement, but derives from the land on which the billboard improvement is situated (i.e., location). In assessing the billboard property, the value attributable to location should be assigned to the land and not to the billboard improvement.

[20] In regard to the Outdoor Advertising Act, see Business and Professions Code section 5200, et seq.
[21] AH-502, pp. 152, 163.
~~[22] See Revenue and Taxation Code section 110(e); AH 502, pp. 154-155.~~

BOARD OF EQUALIZATION
REVENUE ESTIMATE

Assessment of Billboards

Staff Recommendation

Staff recommends that the Board adopt staff's guidelines, which clarify that billboard properties may be valued using an income approach that makes use of the earnings of the business operating a billboard property, and assuming the presence of the special use permits necessary for the operation of the billboard.

Alternative

The proposed alternative text provided by the California State Outdoor Advertising Association (CSOAA) would (1) effectively bar an income approach that makes use of the earnings of the business operating a billboard property and (2) emphasize the exclusion of all value attributable to the intangible special use permit necessary for the operation of the billboard.

Background, Methodology, and Assumptions

Off-premise signs, or billboards, display advertising for products or services that are not located on the same property as the billboard. The billboards are typically constructed and owned by an outdoor advertising, or billboard, company and the advertising space on the billboards is "sold" to advertisers.

It is estimated that there are about 18,000 billboard structures–supporting roughly 26,000 billboard faces–in California. A typical billboard structure costs $50,000 to $100,000 to fabricate and install. A billboard property typically sells for more than the depreciated cost of the billboard structure itself.

There is no effect under the staff's recommended guidelines since they are a restatement of the treatment that should be followed under existing rules.

The average depreciated cost of a billboard improvement in California is estimated to be about $75,000. It is estimated that the average market value of a billboard property under the income and comparative sales approaches is $150,000. However, in staff's view, most of the value difference is attributable to "site influence" of the billboard property and not attributable to the billboard improvement itself. Whatever value is allocated to the interest in land, including the value attributable to the use permit for the billboard, would not be assessable unless a change in ownership of the ground leasehold has occurred under the provisions of article XIII A ("Proposition 13").

Revenue Summary

There will be no revenue effect under the staff recommendation.

Under current practice, many billboard improvements are valued based on depreciated cost. In staff's view, the majority of any value difference between the cost approach and the income or comparative sales approaches is attributable to "site influence." Moreover, staff's view is that the value attributable to the presence of the special use permit necessary for the operation of the billboard also inures to the site. Thus, despite the fact that industry's alternative language would preclude both (1) a valuation based on operating earnings and (2) recognition of any value contributed by the presence of special use permit, it is likely that the immediate revenue effect of the CSOAA alternative would be minimal.

Preparation

This revenue estimate was prepared by Aileen Takaha Lee, Research and Statistics Section. This revenue estimate was reviewed by Mr. David E. Hayes, Manager, Research and Statistics Section, and David Gau, Property Taxes Department. For additional information, please contact Aileen Takaha Lee at (916) 445-0840.

Current as of October 28, 2002.