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January 26, 2009

TO INTERESTED PARTIES:

GUIDELINES FOR SUBSTANTIATING ADDITIONAL OBSOLESCENCE  
FOR STATE-ASSESSED TELECOMMUNICATION PROPERTIES

On December 5, 2008, a draft of the *Guidelines for Substantiating Additional Obsolescence for State-Assessed Telecommunication Properties* was distributed and interested parties were asked to comment on the draft. Enclosed is a matrix summarizing the comments received from interested parties.

An interested parties meeting will be held on February 5, 2009 at the Board's headquarters in Sacramento, 450 N Street, Room 122, 9:30 a.m. to noon, to discuss proposed changes to the *Guidelines*. Subsequently, it is anticipated that the *Guidelines* will be discussed before the Board at the Property Tax Committee meeting on April 15, 2009.

Documents regarding this project are posted on the Board's website at [www.boe.ca.gov/proptaxes/obsolequip.htm](http://www.boe.ca.gov/proptaxes/obsolequip.htm). If you plan to attend the February 5, 2009 meeting, please advise Ms. Sherrie Kinkle at [sherrie.kinkle@boe.ca.gov](mailto:sherrie.kinkle@boe.ca.gov) or at 916-322-2921.

Sincerely,

/s/ Donald Jackson

Donald Jackson, Acting Chief  
State-Assessed Properties Division

DK:sk  
Enclosure

**GUIDELINES FOR SUBSTANTIATING ADDITIONAL OBSOLESCENCE  
FOR  
STATE-ASSESSED TELECOMMUNICATION PROPERTIES  
ALTERNATIVE LANGUAGE**

No.	PAGE/LINE REFERENCE		SOURCE	PROPOSED LANGUAGE	SBE STAFF POSITION
1	1	15	AT&T (R. Strong)	<p><b>Revise paragraph:</b> Of particular interest is the estimation of the additional obsolescence above which is already attributed to the property in the staff's calculation of the replacement cost less depreciation indicator of value. <u>If the SAPD has included in their depreciation, amounts attributed to something other than age dependent depreciation, it needs to be quantified and explained to the taxpayer.</u> The purpose of this document....</p> <p><b>SBE REWRITE:</b> [To be added on Page 6, at line 23] ...Any differences between the degree of obsolescence requested by an assessee in either a study or supporting documents submitted prior to the value setting or in a petition for reassessment and publicly available financial information that Board staff relied upon should be explained and reconciled. <u>Conversely, any additional obsolescence adjustment allowed by staff will be reflected in staff's appraisal work papers.</u></p>	See SBE Rewrite
2	1	17	Thomson Tax & Accounting (P.Hladek)	<p><b>Revise paragraph:</b> The purpose of this document is <u>twofold</u>. <u>First is to provide guidance to interested parties on how to substantiate additional and, or extraordinary obsolescence before the Board. Second. It provides accountability for staff, and a guideline to use in considering claims of additional obsolescence, by creating the framework for supporting or denying the claim. Additionally, it provides assurances that any supporting documentation will be duly reviewed and considered pursuant to the laws, rules and regulations within the State of California, as well generally accepted appraisal theory, and that acceptable of or denial of such claims will be fully documented by staff.</u> It is not a prescription for the automatic acceptance <u>or denial</u> of claims for additional obsolescence, but it will assist Board staff in recommending to the Board what weight to assign to evidence and documentation submitted in support of additional or extraordinary obsolescence.</p>	Not accepted  The <i>Guidelines</i> are a non-exclusive list of conditions that must be met to substantiate additional obsolescence. There may be other assumptions or calculations made that would be inconsistent with the obsolescence study.
3	1	26	AT&T (R. Strong)	<p><b>Revise paragraph:</b> 1. <i>Physical Deterioration.</i> The loss in utility and value due to some physical deterioration in the property. Physical deterioration is considered curable if the cost to cure it is equal to or less than the value added by curing it. <u>Elements of total depreciation that are not physical deterioration must be some form of obsolescence (either functional or external).</u><sup>FN</sup></p> <p><sup>FN</sup> <u>The Appraisal of Real Estate 12<sup>th</sup> Edition, page 398.</u></p>	Not accepted  Suggested text does not add to or clarify the existing language.

No.	PAGE/LINE REFERENCE		SOURCE	PROPOSED LANGUAGE	SBE STAFF POSITION
4	1	29	Verizon Wireless (M. Mupo)	<p><b>Revise paragraph:</b> 2. <i>Functional Obsolescence.</i> The loss in utility and value due to deficiencies and superadequacies attributable to changes in tastes, style, or design. Functional obsolescence <u>can be curable or incurable.</u> It is curable if the cost to cure it is equal to or less than the value added by curing it.</p>	<p>Not accepted</p> <p>The definition is from Board-adopted Assessors' Handbook Section 502.</p>
5	1	29	AT&T (R. Strong)	<p><b>Revise paragraph:</b> 2. <i>Functional Obsolescence.</i> The loss in utility and value due to deficiencies and superadequacies attributable to changes in tastes, style, or design. Functional obsolescence <u>can be curable or incurable.</u> It is curable if the cost to cure it is equal to or less than the value added by curing it</p>	<p>See Item No. 4</p>
6	1	33	Verizon Wireless (M. Mupo)	<p><b>Revise paragraph:</b> 3. <i>External (or Economic) Obsolescence.</i> The loss in utility and value caused by external negative influences outside the property itself; <del>results from the immobility of real property.</del> <u>For real property this may be the result of its immobility, however economic obsolescence can and does exist in personal property also.</u> External obsolescence is typically incurable. <u>External obsolescence can be either temporary (e.g., an oversupplied market) or permanent (e.g., a regulatory requirement such as maintaining analog wireless equipment after more modern equipment is available and economically superior).</u></p> <p><b>SBE REWRITE:</b> <i>External (or Economic) Obsolescence.</i> The loss in utility and value caused by external negative influences outside the property itself; <del>results from the immobility of real property.</del> External obsolescence is typically incurable.</p>	<p>See SBE Rewrite</p> <p>Suggested text does not add to or clarify the existing language.</p>
7	1	33	AT&T (R. Strong)	<p><b>Revise paragraph:</b> 3. <i>External (or Economic) Obsolescence.</i> The loss in utility and value caused by external negative influences outside the property itself; <del>results from the immobility of real property.</del> <u>For real property this may be the result of its immobility, however, economic obsolescence can exist in personal property also.</u> External obsolescence is typically incurable. <u>External obsolescence can be either temporary (e.g., an oversupplied market) or permanent (e.g., proximity to an environmental disaster).</u><sup>FN</sup></p> <p><sup>FN</sup> The Appraisal of Real Estate 12<sup>th</sup> Edition, page 412.</p>	<p>See Item No. 6</p>

No.	PAGE/LINE REFERENCE		SOURCE	PROPOSED LANGUAGE	SBE STAFF POSITION
8	2	18	Verizon Wireless (M. Mupo)	<b>Revise sentence:</b> For example, the replacement of switching equipment with the next generation of switches should follow a schedule that the industry or market would generally employ, <del>not necessarily a complete substitution on the lien date.</del>	No accepted  The language is conditional. The replacement cost study should model market action and conditions and not any one company's actions or a theoretical exercise. A study using a complete substitution without addressing the issue of capital expenditures, availability, and customer adoption and migration considerations is suspect.
9	2	18	AT&T (R. Strong)	<b>Revise sentence:</b> For example, the replacement of switching equipment with the next generation of switches should follow a schedule that the industry or market would generally employ, <del>not necessarily a complete substitution on the lien date.</del>	See Item No. 8
10	2	32	AT&T (R. Strong)	<b>Revise paragraph:</b> If there are excess properties, then the study should consider whether there is residual value and whether the property should be classified as nonunitary. Nonunitary property is property generally considered not essential to the operation of the unit (that is, nonessential property such as excess conduits, land, or building space). <u>To have additional market value over and above the unitary value the property must be separable and unencumbered such that it could be used or sold without adversely impacting the subject unitary property.</u> When this is the case, the property....	Not accepted  Separability is not a prerequisite to a component having value

No.	PAGE/LINE REFERENCE		SOURCE	PROPOSED LANGUAGE	SBE STAFF POSITION
11	4	6	Thomson Tax & Accounting (P.Hladek)	<p><b>Revise paragraph:</b> Cash flow projections should not be an unsupported estimate, but should be backed up by verifiable data. <u>Such data may include but are not limited to internal cash flow projections used for planning and operational aspects, projected budgets used for determining internal financing and operational support. They may be verified by audit procedures and or affidavits filed by the taxpayer. such budgets and projections are usually highly confidential and should be treated as such.</u> Where a study shows capital expenditures will earn less than their cost of capital, verifiable data (such as past history or published company information) must be presented to show that the property has or will have decreased earnings <u>or additional earnings that do not fully support their current cost of investment.</u></p> <p><b>SBE REWRITE:</b> Cash flow projections should not be an unsupported estimate, but should be backed up by verifiable data. <u>Such data may include, but are not limited to, internal cash flow projections used for planning and operational aspects, projected budgets used for determining internal financing, and operational support.</u> Where a study shows capital expenditures will earn less than their cost of capital, verifiable data (such as past history or published company information) must be presented to show that the property has or will have decreased earnings <u>or additional earnings that do not fully support their current cost of investment.</u></p>	See SBE Rewrite
12	6	2	Verizon Wireless (M. Mupo)	<p><b>Revise sentence:</b> An economic life study attempts to measure obsolescence by comparing the property's <del>functional</del> <u>remaining economic</u> life with its remaining physical life.</p>	Accepted
13	6	2	AT&T (R. Strong)	<p><b>Revise sentence:</b> An economic life study attempts to measure obsolescence by comparing the property's <del>functional</del> <u>remaining economic</u> life with its remaining physical life.</p>	See Item No. 12
14	6	4	Verizon Wireless (M. Mupo)	<p><b>Revise paragraph:</b> Estimations of its functional life must be supported with verifiable data. <del>Assertion of technological- and competition-based obsolescence should be supported by the company's investment and replacement patterns studies.</del></p> <p><b>SBE REWRITE:</b> Estimates of its <del>functional</del> <u>remaining</u> life must be supported with verifiable data. Assertion of technological- and competition-based obsolescence should be supported by the company's investment and replacement patterns.</p>	See SBE Rewrite
15	6	4	AT&T (R. Strong)	<p><b>Revise paragraph:</b> Estimations of its functional life must be supported with verifiable data. <del>Assertion of technological- and competition-based obsolescence should be supported by the company's investment and replacement patterns studies.</del></p>	See Item No.14

No.	PAGE/LINE REFERENCE		SOURCE	PROPOSED LANGUAGE	SBE STAFF POSITION
16	6	9	Verizon Wireless (M. Mupo)	<p><b>Revise paragraph:</b> However, often the underlying property is not retired or comparable property continues to be added. These actions do not invalidate the claim for additional obsolescence, but retiring the underlying property or ceasing to add comparable property does add credence that the property has suffered additional obsolescence. <del>A well-substantiated economic life study should show that the market has recognized the property's shortened functional life with a demonstrated pattern of retirement or planned patters of retirement.</del></p> <p><b>SBE REWRITE:</b> However, often the underlying property is not retired or comparable property continues to be added. These actions do not invalidate the claim for additional obsolescence, but retiring the underlying property or ceasing to add comparable property does add credence that the property has suffered additional obsolescence. A well-substantiated economic life study should show that the market has recognized the property's shortened <del>functional</del> <u>remaining</u> life with a demonstrated pattern of retirement or planned patters of retirement.</p>	See SBE Rewrite
17	6	9	AT&T (R. Strong)	<p><b>Revise paragraph:</b> However, often the underlying property is not retired or comparable property continues to be added. These actions do not invalidate the claim for additional obsolescence, but retiring the underlying property or ceasing to add comparable property does add credence that the property has suffered additional obsolescence. <del>A well-substantiated economic life study should show that the market has recognized the property's shortened functional life with a demonstrated pattern of retirement or planned patters of retirement.</del></p>	See Item No. 16
18	7	1	Thomson Tax & Accounting (P.Hladek)	<p><b>Add paragraph:</b> • <u>Regulatory Reports such as SEC Annual Reports (SEC Form 10K) provide commentary and descriptions of issues facing a taxpayer. These reports give insight as to historical performance as well as the potential pitfalls to be faced in the future. Free cash flow calculations, for example, give the appraiser a good idea of the actual return an investor can expect. In particular, when continuing, substantial investments must be made in order to compete in the marketplace, the value of current property may be impaired, even when the property is relatively new. Such continuing replacement investments deplete cash flows from operations, reducing capitalized cash flows and the CEA indicator. The lack of cash flows then cause additional borrowing and or equity placements that can cause bond rating decreases and financial risk, all indicators of diminished value. FASB 157 hierarchy discussion are good indications of the impairment values of property. Because of the rules under FASB 157 in combination with FASB 144 and FASB 142, such discussion in the SEC Form 10k can fully support claims of additional obsolescence when combined with financial results and other supporting studies.</u></p>	Not accepted Proposed text is beyond the scope of the <i>Guidelines</i> . The discussion addresses the valuation of the assessee versus the valuation of the assessee's property.

No.	PAGE/LINE REFERENCE		SOURCE	PROPOSED LANGUAGE	SBE STAFF POSITION
19	7	11	Thomson Tax & Accounting (P. Hladek)	<p><b>Revise paragraph:</b> FASB 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. An impairment write-down is not a prerequisite to recognizing additional obsolescence. However, where they are claims of substantial obsolescence, an impairment write-down would be supportive of such claims. <u>However, as stated in various appraisal manuals including those issued by the Board, External Obsolescence only has to be evident as of the lien date, and not permanent.</u></p>	<p>Not accepted</p> <p>Current text does not preclude giving additional obsolescence for temporary external obsolescence.</p>
20	7	15	Thomson Tax & Accounting (P. Hladek)	<p><b>Revise section:</b> • Statement of Position (SOP) 90-7 – Financial Reporting by Entities in Reorganization Under the Bankruptcy Code. <u>When an entity files for protection under the Bankruptcy code, a bankruptcy emergence plan addresses the value of the property plant and equipment as dictated by the AICPA under SOP 90-7.</u></p> <p><u>The plan is the heart of every Chapter 11 reorganization. An important part of the process of developing a plan is the determination of the reorganization value of the entity that emerges from bankruptcy. Reorganization value generally approximates fair value of the entity before considering liabilities and approximates the amount a willing buyer would pay for the assets of the entity immediately after the restructuring. The reorganization value is the amount of resources available and to become available for the satisfaction of the post-petition liabilities and allowed claims and interest, as negotiated or litigated between the debtor-in-possession or trustee, the creditors, and the holders of equity interests. The reorganization value and the terms of the plan are determined only after extensive arms-length negotiations or litigation between the interested parties and in which all parties develop their own ideas on the reorganization value that will emerge.</u></p> <p><u>Several methods are used to determine the reorganization value; however, generally it is determined by discounting future cash flows for the reconstituted business that will emerge from Chapter 11 and from expected proceeds or collections from assets not required in the reconstituted business, at rates reflecting the business and financial risks involved. Booked costs of emerging entities under fresh start accounting can be excellent indicators of fair market value. However fresh start accounting and a total restatement, only occurs if the emerging legal entity has an ownership change of 51% or more. If the emerging entity has substantially the same ownership, the booked asset carrying costs may be reduced by reducing the lives of those assets and incurring a one time depreciation adjustment that must be considered in determining fair market value.</u></p> <p>• Bankruptcy Sales</p> <p><del>The basic premise of a bankruptcy sales transaction is that it is a distress sales. The sale price would generally.....</del></p>	<p>Not accepted</p> <p>Proposed text is beyond the scope of the <i>Guidelines</i>. The discussion addresses the valuation of the assessee versus the valuation of the assessee's property.</p>