Minnesota Department of Revenue

Adopted Permanent Rules Governing Valuation and Assessment of the Property of Utility Companies

8100.0100 DEFINITIONS.

[For text of subps 1 to 3, see M.R.]

Subp. 3a. **Beta.** "Beta" is the measure of a stock's volatility compared with a measurement of the overall market. A beta of less than one indicates lower-than-market risk; a beta of more than one indicates a higher-than-market risk. Beta is part of the capital asset pricing model.

[For text of subps 4 and 5, see M.R.]

Subp. 5b. **Contributions in aid of construction.** "Contributions in aid of construction" is money paid to another utility, to be used directly or indirectly for the construction or acquisition of plant; or the contribution of property that is used as plant.

Subp. 5c. **Cooperative association.** "Cooperative association" includes municipal power agencies and pipelines that are not common carriers.

[For text of subps 6 to 10, see M.R.]

Subp. 11. **Operating property.** "Operating property" means any tangible property that is owned or leased, except land, which is directly associated with the generation, transmission, or distribution of electricity, natural gas, gasoline, petroleum products, or crude oil. Examples of operating property include, but are not limited to, substations, transmission and distribution lines, generating plants, and pipelines. Property

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that is located on the same or contiguous parcels of land as operating property is presumed to also be operating property. Land is always nonoperating property.

Subp. 11a. **Original cost less depreciation.** "Original cost less depreciation" means the original cost of the property to the present owner, minus any depreciation attributable to the property.

[For text of subps 12 and 13, see M.R.]

Subp. 13a. **Relative risk.** "Relative risk" means the risk of a stock as measured by its beta.

Subp. 13b. **Risk-free rate.** "Risk-free rate" means the theoretical rate of return on an absolutely riskless investment, measured by long-term United States government securities.

Subp. 13c. **Risk premium.** "Risk premium" means the return over and above the risk-free rate.

[For text of subps 14 and 15, see M.R.]

Subp. 16. **Unit value.** "Unit value" means the value of the entire system plant of a utility company taken as a whole without any regard to the value of its component parts.

8100.0200 INTRODUCTION.

The commissioner of revenue establishes an estimate of the unit value for each utility company operating within the state. The entire system is valued utilizing data relating to the cost of the property, the earnings of the company owning or operating the property, and additional indicators of value where applicable. The resulting valuation is allocated to each state in which the utility company operates. The value of property

located in Minnesota that is exempt from property tax or that is locally assessed is subtracted from the value allocated to Minnesota. Next, by the process of apportionment, the portion allocated to Minnesota is distributed to the various taxing districts within the state. The data used in the valuation, allocation, and apportionment process is drawn from reports submitted to the Department of Revenue by the utility companies. These reports include Minnesota Department of Revenue Annual Utility Reports (UTL forms), Reports to the Minnesota Public Utilities Commission, Annual Reports to Shareholders, Annual Reports to the Federal Energy Regulatory Commission, United States Department of Agriculture, Rural Utility Service or equivalent, and other publicly available sources of information regarding rates. Periodic examinations of the supporting data for these reports are made by the Department of Revenue. Finally, the value is equalized based on sales/assessment ratios determined by the Department of Revenue.

The commissioner of revenue reserves the right to exercise discretion whenever the circumstances of a valuation estimate dictate the need for it. Discretion may be used to ensure a balance between a prescriptive rule and sound appraisal judgment; to ensure that all relevant data pertaining to value is considered; to ensure that a reasonable estimate of market value is derived; to address concerns of predictability and stability in estimations of market value; and to ensure that utility valuation is easily understood and administered.

8100.0300 VALUATION.

Subpart 1. **General.** Because of the unique character of public utility companies, the traditional approaches to valuation estimates of property (cost, capitalized income, and market) must be modified when utility property is valued. Consequently, the value of utility company property is estimated in the manner provided in this chapter.

All indicators of value must be considered to determine their validity relating to the specific property being valued. If an indicator is not demonstrated to be reliable or of value for the specific property being appraised it must not be used.

Subp. 2. [See repealer.]

Subp. 3. **Cost approach.**

A. The cost factor to be considered in the utility valuation formula is the original cost less depreciation of the system plant, plus the cost of improvements to the system plant, plus the original cost of all types of construction work in progress that are installed by the assessment date, plus the cost of property held for future use, plus the cost of contributions in aid of construction. Original cost less depreciation is presumed to be equal to historical cost less depreciation. For rate-regulated companies, the commissioner must use the same type of cost that is used in the rate base calculation.

B. The original cost of any leased operating property used by the utility must be reported to the commissioner in conjunction with the annual utility report. If the original cost of the leased operating property is not available, the

commissioner shall make an estimate of the cost by capitalizing the lease payments.

C. If a conflict of opinion exists regarding the character of specific property, whether it is operating or nonoperating property, assessors or utility companies may request a determination by the commissioner.

D. Depreciation is not allowed on construction work in progress. Depreciation is allowed as a deduction from cost in the amount allowed on the accounting records of the utility company, as such records are required to be maintained by the appropriate regulatory agency, except that depreciation may be reduced if available information indicates the amount deducted does not equal actual accrued depreciation when the current estimated remaining life is considered.

E. The following example illustrates how the cost indicator of value is computed for an electric company:

1.	Utility Plant	$200,000,000
2.	Construction Work in Progress	$ 5,500,000
3.	Contributions in Aid of Construction	$ 250,000
4.	Leased Property	$ 750,000
5.	Total Plant	$206,500,000
6.	Book Depreciation	$ 40,000,000
7.	Depreciation on CIAC	$ 10,000
8.	Depreciation on Leased Property	$ 25,000
9.	Total Depreciation	$ 40,035,000
10.	Total Cost Indicator of Value	$166,465,000

Subp. 4. **Income approach.** The income indicator of value is estimated by weighting the capitalized net operating earnings of the utility company for the most recent three years as follows: most recent year, 40 percent; previous year, 35 percent; and final year, 25 percent. Utilities may request the removal of nonrecurring items of income or expense. The

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commissioner must determine if removal of the item is appropriate. The net income is capitalized by applying a capitalization rate that is computed by using the band of investment method. This method considers:

A. the capital structure of utilities;

B. the cost of debt or interest rate;

C. the yield on preferred stock of utilities;

D. the yield on common stock of utilities; and

E. the risk-free rate, relative risk, and risk premiums for public utility companies.

Capitalization rates are computed for electric companies, gas distribution companies, natural gas transmission systems, and fluid pipeline companies. The rates are recalculated each year using the method described in this subpart.

The following example illustrates how the income indicator of value would be computed for a gas distribution company:

		year 1	year 2	current year
1.	Net Operating Income	$ 394,000	$ 450,000	$ 470,000
2.	Weighting Factor	25%	35%	40%
3.	Weighted Income to be Capitalized	98,500	157,500	188,000
4.	Capitalized Income at 9.25%	1,064,865	1,702,703	2,032,432
5.	Total Income Indicator of Value			$4,800,000

Subp. 4a. **Additional indicators of value.** Additional indicators of value, other than the cost and income indicators, may exist in some situations. When additional indicators of value exist, the commissioner has the discretion to use these additional indicators in computing the unit value of a utility.

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Additional indicators of value include, but are not limited to, the market indicator.

A. If the commissioner determines that the market indicator can be quantified, is reliable, and is indicative of value for a company, the commissioner has the discretion to adjust the weightings of the cost and income indicators to give weight to the market indicator in the unit value computation. If the market indicator is used, the weighting for the market indicator must not exceed five percent.

B. If the commissioner finds that economic or other forms of obsolescence exists, the commissioner has the discretion to adjust the weightings in the correlation process described in subpart 5 or make other adjustments in its methodology consistent with these rules and applicable statutes.

C. If the commissioner uses additional indicators of value, the commissioner must state in writing the findings that necessitate deviation from the default weightings of 50 percent for cost indicator and 50 percent for income indicator, as described in subpart 5.

Subp. 5. **Unit value computation.** The unit value of the utility company is equal to the total of the weighted indicators of value. The total weighting must equal 100 percent. The default weightings of the indicators are: market indicator, 0 percent; cost indicator, 50 percent; income indicator, 50 percent.

The following is an example of the computation of the unit value for a utility company when the market indicator has been

determined to be a valid additional indicator of value:

1. Cost Indicator of Value:
$5,000,000 x 47.5% = $2,375,000
2. Income Indicator of Value:
$4,800,000 x 47.5% = $2,280,000
3. Market Indicator of Value:
$5,500,000 x 5% = $275,000
4. Unit Value of Utility Company:
Sum of indicators = $4,930,000

Subp. 5a. **Valuation election for cooperative associations.** After assessment year 2007, cooperative associations have the option to irrevocably elect the method under which they are valued.

A. For assessment year 2007, each cooperative must be valued in the same manner as it was valued in assessment year 2006, using either the unit value method or cost less depreciation method.

B. Beginning in assessment year 2008, cooperative associations that were valued under the cost less depreciation method in assessment year 2007 may irrevocably elect to be valued using the unit value method described in subparts 1 to 5. Elections made by a cooperative association prior to November 1 of any year are effective the next assessment year. Such elections must be in a format prescribed by the commissioner.

C. Prior to November 1 of assessment year 2008, cooperative associations that were valued under the unit value method in assessment year 2007 may irrevocably elect to be valued under the cost less depreciation method. Such elections will be in a format prescribed by the commissioner. Cooperative associations that do not elect to revert back to valuation using

cost less depreciation method prior to November 1 of assessment year 2008, are deemed to have irrevocably elected to be valued using the unit value method.

Subp. 6. **Cost less depreciation method of valuation for utility property of cooperatives, municipal power agencies, and pipelines that are not common carriers.** Cooperative associations may irrevocably elect to have their property valued using the unit value method described in subparts 1 to 5. Cooperative associations not electing unit valuation and other types of utilities which do not operate in the traditional profit-making mode, are not common carriers, or are nonregulated, must have their utility property valued on the basis of cost less depreciation. Elections made by a cooperative association prior to November 1 of any year are effective the next assessment year. Such elections must be in a format prescribed by the commissioner.

A. Depreciation is allowed as a deduction from the original cost in increments of 2-1/2 percent per year, but the maximum depreciation allowed must not exceed 75 percent of the cost of the utility operating property. Additions to existing utility property are depreciated 2-1/2 percent per year until they reach the 75 percent maximum. Retirements of utility property are deducted from the cost basis at the average depreciation level of all of the company's taxable property.

B. Cost less depreciation is calculated by using the following inputs: the total cost at the end of the year preceding the assessment year; total depreciation at the

beginning of the year preceding the assessment year; total cost at the beginning of the year preceding the assessment year; and the original cost of property retired during the year preceding the assessment year.

Depreciation for the year is calculated by multiplying the total cost at the end of the year preceding the assessment year by 2-1/2 percent. Depreciation on retirements is calculated by dividing the total depreciation for the year preceding the assessment year by total cost at the beginning of the year preceding the assessment year. This number is then multiplied by the original cost of retirements for the year; the result is equal to the depreciation on retirements for the year.

Net depreciation for the year is calculated by adding the total depreciation at the beginning of the year preceding the assessment year and the depreciation for the year, and then subtracting the depreciation on retirements for the year. Net depreciated value for the year is equal to the total cost at the end of the year preceding the assessment year less net depreciation for the year. Net depreciated value for the assessment year is the total market value for all property owned by the company.

A company factor is calculated by dividing the net depreciated value for the assessment year by the total cost at the end of the year preceding the assessment year. The factor is multiplied by the cost of each individual parcel at the end of the year preceding the assessment year to derive the market value of each individual parcel.

C. The following example illustrates this process for an electric cooperative association electing cost less depreciation valuation under this subpart for assessment year 2006.

Cost of individual parcels on 12/31/2005 =	$105,000
	$520,000
	$415,000
	$100,000
Total cost on 12/31/2005 of all property =	$1,140,000
Total depreciation on 1/1/2005 =	$300,000
Total cost on 1/1/2005 =	$1,100,000
Original cost of retirements in 2006 =	$6,000
1. Depreciation for the assessment year 2006 ($1,140,000 x .025) =	$28,500
2. Depreciation on assessment year 2006 retirements ($300,000 / $1,100,000) x $6,000 =	$1,636
3. Net depreciation for the assessment year 2006 ($300,000 + $28,500 - $1,636) =	$326,864
4. Depreciation Limit ($~~1,140~~ $1,140,000 x .75) =	$855,000
5. Net depreciated value for the assessment year 2006 (Total cost on 12/31/2005 - Lesser of Line 3 or Line 4) ($1,140,000 - $326,864) = This is the market value for all property owned by the cooperative.	$813,136
6. Company depreciation factor for 2006 ($813,136 / $1,140,000) =	71.327751%
7. Market value of each individual parcel ($105,000 x 71.327751%) =	$74,900
($520,000 x 71.327751%) =	$370,900
($415,000 x 71.327751%) =	$296,000
($100,000 x 71.327751%) =	$71,300

Subp. 8. **Retirements.** Utility operating property may be retired from the utility system while still in place if certain criteria are met:

A. The property must be physically disconnected from

the utility system. In the case of electrical plants, the disconnection or dismantling of wires, cables, connectors, or transformers constitutes physical disconnection. In the case of pipelines, the disconnection of pipes, valves, or fittings is evidence of physical disconnection.

B. An affidavit of retirement must be filed by the utility with the commissioner at least 30 days prior to the assessment date. This affidavit must indicate the facility being retired and the date it was taken out of service.

C. The utility must make every effort to inform the commissioner of pending major retirements. The commissioner in turn shall notify the county assessor of impending major retirements as soon as this information becomes available to the department.

D. Utility real property which is retired in place must continue to be taxed for ad valorem purposes. However, its market value is not determined on the basis of its value as utility operating property.

E. If a utility chooses to temporarily retire a facility pending the development of an alternate fuel, greater demand, increased source of supply, or another valid reason, the cost of this facility must be transferred to the appropriate regulatory agency's account entitled "Held for Future Use." Standby facilities are not considered to be temporarily retired unless their costs are carried in this account. Temporarily retired utility facilities are valued taking into account a number of factors including age of the facility, type of

facility, amount of maintenance and additional costs needed to restore the facility to operational status, length of retirement, and earning potential of the facility. A temporarily retired facility must not be valued lower than if the facility were considered nonoperating utility property.

8100.0400 ALLOCATION.

Subpart 1. **General.** After the unit value of the utility property has been estimated, the portion of value which is attributable to Minnesota must be determined. Each of the factors in the allocation formula is assigned a weighted percentage to denote the relative importance assigned to that factor. The resulting sum of the weighted factors multiplied by the unit value yields the valuation of the utility property which is, after the adjustments described in part 8100.0500, subject to ad valorem tax in the state of Minnesota.

[For text of subp 2, see M.R.]

Subp. 3. **Gas distribution companies.** The allocation of value of gas distribution companies must be made considering the same factors as are used to determine the allocation of value of electric companies. The weight given to the original cost factor is 75 percent, and gross revenue is weighted 25 percent.

Subp. 4. **Pipeline companies.** The allocation of pipeline companies is equal to the original cost of the utility property located in Minnesota divided by the total original cost of the property in all states of operation weighted at 75 percent. Additionally, throughput of product from operations in Minnesota divided by throughput of product from operations in all states

is weighted at 25 percent.

The following example illustrates the allocation of value of property of a pipeline company and the weights given to each factor:

1.	Minnesota Plant Cost	$13,500,000	x .75 = 25.76%
2.	System Plant Cost	$39,300,000	
3.	Minnesota Throughput (Mcf or Barrel miles)	8,940,000	x .25 = 8.01%
4.	System Throughput (Mcf or Barrel miles)	27,900,000	
5.	Total Percentage Allocable to Minnesota		33.76%

8100.0500 ADJUSTMENTS FOR NON-FORMULA-ASSESSED OR EXEMPT PROPERTY.

Subpart 1. **Deduction for exempt or non-formula-assessed property.** After the Minnesota portion of the unit value of the utility company, except for electric cooperatives, is determined, any property which is non-formula-assessed or which is exempt from ad valorem tax, is deducted from the Minnesota portion of the unit value. Only that qualifying property located within the state of Minnesota may be excluded.

Subp. 2. **Valuation formula not applicable to certain utility property.** The following properties are valued by the local or county assessor and, therefore, the formula provided herein for the valuation of utility property is not applicable to such property:

A. land;

B. nonoperating property; and

C. rights-of-way.

Subp. 3. **Deduction for cost of land and rights-of-way;**

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application to nonoperating property. The Minnesota portion of the unit value is reduced by the value included in the unit value of the company for land, rights-of-way, nonoperating property, and exempt property. This amount is calculated by determining the ratio of the unit value computed in part 8100.0300, subpart 5, to the cost less depreciation allowed in part 8100.0300, subpart 3. This ratio is multiplied by the cost less depreciation of the property to be deducted.

Subp. 4. [See repealer.]

Subp. 4a. [See repealer.]

Subp. 5. **Burden of proof and responsibility of utility company.** The utility company has the burden of proof to establish that the value of any property should be excluded from the Minnesota portion of the unit value. Accordingly, the utility company has the responsibility to submit, in the form required by the commissioner of revenue, such schedules of exempt or non-formula-assessed property as the commissioner may require.

8100.0800 PHASE-IN.

Subpart 1. **Phase-in of valuation changes.** Any change in valuation is phased in over three years. For assessment years 2007, 2008, and 2009, each utility property must be valued both under the valuation process of current Minnesota Rules, chapter 8100, ("current rules") and under the valuation process of Minnesota Rules 2005, chapter 8100, as amended through March 2, 2000, ("old rules"). The difference, either positive or negative, between the value derived under the current rules and

the value derived under old rules is incrementally added to the value derived under the old rules as follows:

For assessment year 2007, 20 percent of the difference is added to the value derived under the old rules; this amount is the assessed value for 2007.

For assessment year 2008, 50 percent of the difference is added to the value derived under the old rules; this amount is the assessed value for 2008.

For assessment year 2009, and all subsequent assessment years, the full value derived under the current rules is the assessed value.

Subp. 2. **Examples of phase-in valuations.** The following example illustrates a valuation when the value derived using the old rules exceeds the value derived using the current rules:

1. Value for Assessment Year 2007	
Value under current rules	$10,750,000
Value under old rules	$12,000,000
Difference between old and current value	$ 1,250,000
20% of difference	$ 250,000
Assessed Value	$11,750,000
2. Value for Assessment year 2008	
Value under current rules	$10,900,000
Value under old rules	$12,750,000
Difference between old and current values	$ 1,850,000
50% of difference	$ 925,000
Assessed Value	$11,825,000
3. Value for Assessment Year 2009	
Value under current rules	$11,750,000
Assessed Value	$11,750,000

The following example illustrates a valuation when the value derived using the old rules is less than the value derived using the current rules:

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1. Value for Assessment Year 2007

Value under current rules	$15,000,000
Value under old rules	$13,500,000
Difference between old and current values	$ 1,500,000
20% of difference	$ 300,000
Assessed Value	$13,800,000

2. Value for Assessment Year 2008

Value under current rules	$15,250,000
Value under old rules	$14,250,000
Difference between old and current values	$ 1,000,000
50% of difference	$ 500,000
Assessed Value	$14,750,000

3. Value for Assessment Year 2009

Value under current rules	$16,600,000
Assessed Value	$16,600,000

EFFECTIVE DATE. These amendments to Minnesota Rules, chapter 8100, are effective for assessment year 2007 and following assessment years.

REPEALER. Minnesota Rules, parts 8100.0300, subpart 2; and 8100.0500, subparts 4 and 4a, are repealed.

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