

## COMPANY POLICY MEMORANDUM

**DATE:** Monday, January 05, 2015  
**TO:** Pipeline Taxpayers/Agents  
**RE:** Valuation Estimates of Economic Obsolescence

The appraisal consulting firm of Pritchard & Abbott, Inc. (P&A), is contractually obligated to many Texas appraisal districts to appraise mineral, industrial, utility, and related business personal property for ad valorem tax purposes. Therefore P&A assumes the constitutional and fiduciary responsibilities to appraise property at Fair Market Value as defined in Property Tax Code, Sec. 1.04(7), as of January 1, in a uniform manner with all similarly situated property.

To fully satisfy these appraisal responsibilities, we've come to the conclusion that P&A needs to modify its internal valuation practices with regards to the estimation of economic obsolescence (EO), a component of depreciation, when using a schedule-based Replacement Cost New Less Depreciation (RCNLD) cost approach to value. This policy change will be applicable beginning tax year 2015 to non-regulated pipelines such as gathering lines or other intrastate pipelines (not flow lines or lease lines which are part of leasehold personal property equipment). This policy change may apply to other property types in future tax years.

One method we've used for decades to estimate EO is with application of a Percent Good factor as calculated with a modified Chilton-based formula that references "throughput" (also called utilization) as compared to capacity. *[The original Chilton factor is an equation that dates back to approximately 1950. This factor was created for estimating construction costs of industrial processes and plants based on production capacity. The Chilton equation recognizes the exponential relationship encountered when scaling a known cost by using a ratio between a known and a proposed production capacity. In simpler terms, the Chilton formula is based on economies of scale. Constructing a facility that has twice the production capability does not double the construction cost, for example.]* This throughput formula technique has been widely adopted in Texas primarily because it works fairly efficiently in a mass-appraisal environment, but also because it produces plausibly accurate and/or defensible estimations of property value loss due to forces external to the property itself. However, this is assuming the throughput and/or capacity figures inserted into the formula are truly reflective of the property being appraised.

**Because there is no reliable method for P&A to calculate either throughput or capacity of pipelines, P&A will no longer accept these figures for any particular segment or system except through correspondence directly from the pipeline companies themselves. This correspondence should be on taxpayer company letterhead or email and include the basis of the throughput and capacity calculations. In addition, this correspondence should be signed by a taxpayer company representative who would be willing and able to discuss the calculations with us in an official capacity.**

(cont.)

Please note, this valuation policy change only affects this one component (economic obsolescence) of depreciation. It does not affect the physical deterioration and functional obsolescence components of depreciation, nor does it affect the determination of Replacement Cost New (RCN) or the appraisal of the larger interstate pipelines that are typically appraised with “unitary” methodology in which all three approaches to value (cost, market, income) are explicitly considered. Also, regarding the throughput calculations, P&A will continue to use our modified Chilton formula equation that “floors” at ten (10) percent good for completely idle pipe segments/systems (i.e., zero throughput or utilization) that have no ascertainable potential for reactivation in the foreseeable future.

P&A continually strives to improve our appraisal process with regards to all property types and property owners, and accurate data acquisition plays a key role. Please rest assured this is most definitely **not** a “value grab” as the overriding thrust is to help ensure we appraise similarly situated properties in a uniform manner. P&A remains committed to providing professional, fair, and timely property tax appraisal and information services to our clients, thereby assisting state and local taxing authorities to affect positive economic and educational development with the communities we serve.

Thank You.

