

Ad Valorem Valuation of Utility Real Estate

I. There are many unique issues to be addressed in the valuation of utility real estate.

A. Brief overview of issues to be discussed throughout the presentation:

- i. Interweaving of non-real estate assets;
- ii. Power purchase agreements;
- iii. Exemptions (e.g., pollution control);
- iv. Bonus depreciation;
- v. Investment tax credit;
- vi. Environmental remediation expenses;
- vii. Highest and best use;
- viii. Zoning non-conformities; and
- ix. Specialized management.

II. Personal property and intangibles such as business value or goodwill are not to be valued.

A. Real property is to be valued at its fair market value according to its highest and best use (i.e., maximally productive use)

- i. This valuation typically should not include personal property or intangibles.

III. Highest and Best Use

A. Factors in Determining Highest and Best Use:

- x. Zoning/land use
- xi. Nonconforming use problems
- xii. Environmental
- xiii. Operating permits
 - a. Holding an operating permit is critical.
- xiv. Disposal permits
- xv. Traffic/over-the-road licenses

B. In general, whether a power plant has the required permits and licenses to be operational, and whether it is (non-)conforming relates to its highest and best use (i.e., are the uses of the property legally permissible?).

IV. Distinguishing Factors from Other Property Types

- A. Power purchase agreements (PPA)
 - i. PPAs are long-term contracts between energy producers (e.g., power plant operators) and a customer or group of customers.
 - a. Typically, PPAs will guarantee the customer an amount of electrical capacity for payment.
 - ii. The value of a PPA that is independent of the property should not be included in the valuation (See Mesquite Power LLC v. Arizona Department of Revenue, 258 Ariz. 1 (2024))
- B. Exemptions – pollution control
 - i. Factors such as exemptions for power plants from federal emissions requirements may allow for greater electricity generation, which in turn could result in higher valuations based on potential income stream and maximum economic potential of the property.
 - ii. See: <https://apnews.com/article/trump-coal-power-plants-epa-exemptions-zeldin-2cd9f2697b5f46a88ab9882ab6fd1641>
- C. Bonus depreciation
- D. Investment tax credits
 - i. These tax credits incentivize the development of power plants by permitting developers to write off a portion of project costs from their tax liability –
 - ii. Often available to solar and clean electricity generation facilities
 - iii. Tax credits lower the overall cost of reproduction for such facilities, but not necessarily relevant to the RCNLD cost approach since they do not alter the actual construction cost or value of the facility.
- E. Rate floor agreements
 - i. Like PPAs, rate floor agreements set a minimum price that a power plant operate will receive for the electricity produced.
 - ii. Like PPAs, such value – to the extent that it is independent of the property – should be excluded from value.

V. Business/Intangible Assets

- A. Work force in place
 - i. There is intangible value to the operation by having a trained work force in place. When considering the value of a power plant, this factor should be excluded as unique to the business operation and not related to the property value.
- B. Disposal rights – nuclear waste

- C. Rate setting limitations
- D. Management contracts
 - i. Like work force in place, these contracts allow property owners to bring in management groups to manage the business operation. Such agreements may have value to the *business* of the power plant, but are intangibles that should not be valued in the property valuation.
- E. Access to fuel

VI. Cost Approach

- A. Power plant is a specialty property requiring use of the RCNLD cost approach.
- B. Discussion of cases:
 - xvi. Long Island Lighting Company v. Assessor for Town of Brookhaven, 616 N.Y.S.2d 376 (1994) – the power plant is a specialty property which requires use of the RCNLD cost approach.
 - xvii. In re PP&L, Inc., 838 A.2d 1 (Pa. Commw. Ct. 2003) – When applying the cost approach, the specific use of the property and value of that use to the owner are not relevant.

VII. Income Approach

- A. Role of power purchase agreements
 - i. Under the income approach courts have allowed consideration of income derivable from power purchase agreements in some instances.
- B. Discussion of cases:
 - i. Mesquite Power LLC v. Arizona Department of Revenue, 258 Ariz. 1 (2024) - income from a Power Purchase Agreement is properly considered as part of an income approach (but, value of the PPA that is independent from the property should be deducted from the income approach valuation)
 - ii. Watson Co-Generation Co. v. Los Angeles, 98 Cal. App. 4th 1066 (2002) – consideration of PPA in income approach by the City was proper.

VIII. Market Approach

- A. Dominion Nuclear v. Waterford, 2007 WL 4171584 (Conn. Super. Ct. Nov. 8, 2007) – this is a case that involved an actual sale of the power plant in question. Recognizing that “a prudent purchaser would pay no more than the cost of acquiring [a power plant],” the court considered this as good evidence as to value, subject to adjustments for intangibles and value to the business enterprise.

- B. Limitations to the use of the market approach
 - ii. Availability/reliability of data/allocations by parties to transaction
 - iii. Search of “sales”/how many property qua transactions?

IX. Business Enterprise Valuation

- A. Mark Pomykacz, MAI & Chris Olmsted, THE APPRAISAL OF POWER PLANTS, *The Appraisal Journal* 216–230 (2014).
 - i. What Pomykacz and Olmsted call the “going concern” refers to the business enterprise including intangible elements including a trained work force, licenses, tax incentives, etc.
 - ii. They suggest that the first step to the income approach *requires* determining the value of the business enterprise for the plant, and the subsequent use of other appraisal techniques to separate the intangibles from the value of the personal property and real property.
- B. Lack of case law on the use of the business enterprise valuation approach
 - i. Dominion Nuclear v. Waterford, 2007 WL 4171584 (Conn. Super. Ct. Nov. 8, 2007) – both appraisers used a business enterprise approach, which the court dismissed. Nevertheless, the court acknowledged that it was required to utilize the business enterprise approach on its own to try to separate some of the intangibles and the business operation from the sale of the power plant, to yield the value of the real and personal property.