

MASS APPRAISAL REPORT
UTILITY, RAILROAD, AND PIPELINE PROPERTIES
APPRAISED BY CAPITOL APPRAISAL GROUP, INC.

2021-2022

Overview

This type of property consists of operating property, excluding land, owned by utility, railroad, and pipeline companies, and related personal property and improvements. Capitol Appraisal Group, Inc. is contracted to reappraise this type of property according to the scope of work in the normal course of business of the client consistent with the Uniform Standards of Professional Appraisal Practice guidelines. The completed appraisals are all retrospective in nature. The purpose of the appraisals is to estimate market value as of January 1 in accordance with the definition of market value established in the Texas Property Tax Code (Sec. 1.04). "Market value" means the price at which a property would transfer for cash or its equivalent under prevailing market conditions if:

- A. exposed for sale in the open market with a reasonable time for the seller to find a purchaser;
- B. both the seller and the purchaser know of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions on its use; and
- C. both the seller and purchaser seek to maximize their gains and neither is in a position to take advantage of the exigencies of the other.

The effective date of the appraisals is January 1 of the year for which this report is submitted unless the property owner or agent has applied for and been granted September 1 inventory valuation as allowed by Section 23.12(f) of the Texas Property Tax Code. The date of this report is April 20 of the tax year for which it is submitted.

The client for the mass appraisal is the Texas appraisal district named on the last page of this report. The intended users of this report are the client and the property owners of the client appraisal district

The appraisal results will be used as the tax base upon which a property tax will be levied. The properties are appraised in fee simple in conformance with the Texas Property Tax Code Sec. 25.06. This is a jurisdictional exception to Standards Rule 6-5 (c) comment of the Uniform Standards of Professional Appraisal Practice 2008. A listing of the utility, railroad, and pipeline properties appraised by Capitol Appraisal Group, Inc. for the appraisal district is available at the appraisal district office. Such utility, railroad, and pipeline properties that are susceptible to inspection (e.g. compressor stations, pump stations, buildings, and power plants) are normally re-inspected at least every three years.

Capitol's utility, railroad, and pipeline appraisal staff includes licensed engineers as well as experienced appraisers who are knowledgeable in all three approaches to value. The appraisal staff stays abreast of current trends affecting utility, railroad, and pipeline properties through review of published materials, attendance at conferences, course work, and continuing education. All appraisers are registered with the Texas Board of Tax Professional Examiners.

Assumptions and Limiting Conditions

All appraisals are subject to the following assumptions and limiting conditions:

1. Title to the property is assumed to be good and marketable and the legal description correct.
2. No responsibility for legal matters is assumed. All existing liens, mortgages, or other encumbrances have been disregarded and the property is appraised as though free and clear, under responsible ownership and competent management.
3. The appraisers developing these appraisals are not Requested to give testimony or attendance in court by reason of the appraisals, unless directed by, employed by, and provided legal counsel by the Appraisal District.
4. The appraisers do not necessarily inspect every property every year.
5. All sketches on the appraisal documents are intended to be visual aids and should not be construed as surveys or engineering reports unless otherwise specified.
6. All information in the appraisal documents has been obtained by members of Capitol Appraisal Group's staff or by other reliable sources.
7. The appraisals were prepared exclusively for ad valorem tax purposes.
8. The appraisers have inspected as far as possible, by observation, the improvements being appraised, however, it is not possible to personally observe conditions beneath the soil or hidden structural components within the improvements. Therefore no representations are made as to these matters unless specifically considered in an individual appraisal.

Data Collection and Validation

Data on the subject properties is collected as part of the inspection process and through later submissions by the property owner. Submitted data may be on a rendition form or in other modes which require confidentiality. Subject property data is verified through previously existing records and through published reports. Additional data are obtained and verified through published sources, regulatory reports, and through analysis of comparable properties. Due to the varied nature of utility, railroad, and pipeline properties there is no standard data collection form or manual.

Valuation Approach and Analysis

For all pipelines a value is calculated using a Replacement Cost New Less Depreciation (RCNLD) model. This involves first calculating the cost of building a new pipeline of equal utility using current prices. The Replacement Cost New (RCN) is a function of location, length, diameter, and composition. Depreciation is then subtracted from RCN to produce the final value estimate. Depreciation is defined as the loss of value resulting from any cause. The three common forms of depreciation are physical, functional, and economic. Physical depreciation is accounted for on the basis of the age of the subject pipeline. Functional and economic obsolescence (depreciation) can be estimated through the use of survivor curves or other normative techniques. Specific calculations to estimate abnormal functional and/or economic obsolescence can be made on the basis of the typical utilization of the subject pipeline.

After deductions from RCN have been made for all three forms of depreciation the remainder is the RCNLD or cost approach model indicator of value.

In addition to the RCNLD indicator, a unit value model may also be used for those pipelines for which appropriate income statements and balance sheets are also available. Generally, this model is used for those pipelines that by regulation are considered to be common carriers. The unit value model must be calculated for the entire pipeline system.

The unit value model typically involves an income approach to value and a rate base cost approach. The income approach is based on a projection of expected future typical net operating income (NOI). The projected NOI is discounted to a present worth using a current cost of capital that is both typical of the industry and reflective of the risks inherent in the subject property. The unit value model cost approach is typically an estimation of the current rate base of the subject pipeline (total investment less book depreciation allowed under the current form of regulation). An additional calculation is made to detect and estimate economic obsolescence. Any economic obsolescence is deducted from the rate base cost less book depreciation to achieve a final cost indicator. The unit value model may also include a stock and debt approach in lieu of a market data approach. The stock and debt approach involves finding the total value of the owner's liabilities (equity and debt) and assuming that they are equal to the value of the assets. The two (or three, if the stock and debt approach is included) unit value indicators are then reconciled into a final unit appraisal model indicator of value. The unit value must then be reconciled with the RCNLD model indicator of value for the entire pipeline system being appraised. The final correlated value of the system can then be allocated among the various components of the system to determine the tax roll value for each pipeline segment.

Utility and railroad properties are appraised in a manner similar to pipeline except the RCNLD model is not used. For all three types of property (utility, railroad, and pipeline) the appraiser must first form an opinion of highest and best use. If the highest and best use of the operating property is the current use under current regulation, the unit value model is considered highly appropriate. If the highest and best use is something different, then the RCNLD model may be more appropriate.

Compressor stations, pump stations, improvements, and related facilities are appraised using a replacement cost new less depreciation model.

Model calibration in the RCNLD model involves the selection of the appropriate service life for each type or class of property. Further calibration can occur through the use of utilization or through-put data provided by the owner or agent. Model calibration in the unit value cost approach involves the selection of the appropriate items to include in the rate base calculation and selection of the best measure of obsolescence, if any. Income approach calibration involves the selection of the cost of capital or discount rate appropriate to the type of property being appraised as well as adjusting the projected income stream to reflect the individual characteristics of the subject property. Model calibration in the stock and debt approach involves allocating sales prices of debt and equity to reflect the contribution to value of the operating property of the subject company.

The mathematical form of each model is described below.

RCNLD Approach

$$\begin{aligned} & \text{RCN} \\ & -\text{PD} \\ & -\text{FO} \\ & -\text{EO} \\ & =\text{RCNLD Indicator of Value} \end{aligned}$$

Where:

RCN = Replacement or Reproduction Cost New

PD = Physical Depreciation

FO = Functional Obsolescence

EO = Economic Obsolescence

Unit Cost Approach

$$\begin{aligned} & \text{OC} \\ & -\text{AD} \\ & \underline{-\text{EO}} \\ & =\text{Unit Cost Approach Indicator of Value} \end{aligned}$$

Where:

OC = Original Cost

AD = Allowed Depreciation

EO = Economic Obsolescence

Unit Income Approach

$$\begin{aligned} & \text{PGR} \\ & -\text{VCL} \\ & -\text{FE} \\ & \underline{-\text{VE}} \\ & \text{NOI} \end{aligned}$$

$$\text{NOI/R} = \text{Income Indicator of Value}$$

Where:

PGR = Potential Gross Rent

VCL = Vacancy and Collection Loss

FE = Fixed Expenses

VE = Variable Expenses

R = Discount Rate or Cost of Capital

A variation of the income model is:

NOI for year 1 x DF for year 1 = PW of year 1 NOI

NOI for year n x DF for year n = PW of year n NOI

Net Reversion x DF for year n = PW of Reversion

Sum of PW's for all years 1 - n = Income Indicator of Value

Where:

NOI = Net Operating Income

DF = Discount Factor

PW = Present Worth

n = Last year of holding period

Stock and Debt Approach

$$\begin{aligned} & \text{MVE} \\ & +\text{MVD} \\ & =\text{Market Value of Assets} \end{aligned}$$

Where:

MVE = Market value of Equity

MVD = Market value of Debt

In reconciling multiple model results for a property the appraiser considers the model results that best address the individual characteristics of the subject property while maintaining equalization among like properties. Final results for each property may be found on the appraisal district's appraisal roll.

Land valuation for utility and pipeline properties is the responsibility of appraisal district staff as is the highest and best use analysis of the site. Sites are analyzed for highest and best use as though they were vacant. Highest and best use analysis of the improvements is based on the likelihood of the continued use of the improvements in their current and/or intended use. Railroad corridor land is included in the appraisal of the operating property. The highest and best use of railroad corridor land is presumed to be as operating property. An appraiser's identification of a property's highest and best use is always a statement of opinion, never a statement of fact.

The rate-base cost approach, stock and debt approach, and income approach models must be reduced by the value of the land in order to arrive at a value of improvements, personal property, and other operating property.

Review and Testing

Field review of appraisals is performed through the regular inspection of subject properties. The periodic reassignment of properties among appraisers or the review of appraisals by an experienced appraiser also contributes to the review process. A computer-assisted statistical review of property value changes is also conducted.

Appraisal to sales ratios are the preferred method for measuring performance, however sales are very infrequent. Furthermore, market transactions normally occur for multiple sites and include both real and personal property, tangible and intangible, making analysis difficult and subjective. Performance is also measured through comparison with valid single-property appraisals submitted for staff review. Appraisal results are tested annually by the Property Tax Division of the Texas Comptroller's Office. The Comptroller's review as well as comparisons with single-property appraisals indicate the validity of the models as well as the calibration techniques employed.