ADMINISTRATIVE NOTICE 97-09

SUBJECT: Property Tax -- State Tax Commissioner's Policy Statement Concerning Primary Reliance on the Market Comparable Approach for Appraising Reserve Coal and Other Mined Minerals Pursuant to CSR § 110-1I-4 and CSR § 110-1K-4.

On July 26, 1992, the Department of Tax and Revenue filed Legislative Regulations CSR § 110-1I-1 et seq. (for the appraisal of producing and reserve coal properties) and CSR § 110-1K-1 et seq. (for the appraisal of producing other mined mineral properties). This notice will address these regulation's primary reliance on the market comparable approach to value when appraising reserve coal and other mined mineral properties for property tax purposes.

DISCUSSION

There are three (3) generally accepted approaches to value that must be considered when estimating market value of properties for ad valorem tax purposes. These are the cost, market, and income approaches to value. These approaches to value must be considered and should be developed, if appropriate, to properly estimate market value in compliance with generally accepted appraisal principles. The following is a brief discussion of these three (3) approaches to value and their potential use when estimating the market value of reserve coal and reserve natural resource properties other than coal and oil and gas for ad valorem tax purposes.

COST APPROACH

The cost approach to value is based upon the assumption that the cost of a property, less depreciation (loss in value), yields a reasonable estimate of market value. There are three (3) generally accepted types of cost approach appraisal methods; these are: original cost less depreciation, reproduction cost less depreciation, and replacement cost less depreciation. Depreciation is a loss in value due to physical deterioration through use, functional obsolescence through design or utility and economic obsolescence due to outside market forces.

Original cost less depreciation is the cost of acquisition of a property less a loss in value due to physical deterioration, functional obsolescence and economic obsolescence. This approach is widely employed in the appraisal of "cost-based" regulated utilities, however it has a limited application when appraising reserve natural resource properties, as many of these types of properties were acquired years ago at substantially less than current market value.

Reproduction cost, less depreciation, is the cost of reproducing an exact replica of a property less physical deterioration, functional obsolescence, and economic obsolescence. This approach is employed in appraising one-of-a-kind properties such as works of art or special purpose properties, an example of which is the State's Capitol Building. Coal and other mineral properties are a nonrenewable natural resource and can therefore not be reproduced. Because of their nonrenewable nature, reserve natural resource properties do not lend themselves to development of a reproduction cost less depreciation appraisal.

Replacement cost less depreciation is the cost of replacing a property with one of like utility less physical deterioration and economic obsolescence. This approach is the most widely used of the three (3) cost approaches to value and is widely employed in appraising of commercial and industrial personal property. Replacement cost has limited application, however, in the appraisal of nonrenewable natural resource properties, as the resource cannot, by its nature, be replaced. Because of their nonrenewable nature, reserve natural resource properties do not lend themselves to the development of replacement cost new less depreciation appraisals.

INCOME APPROACH

The income approach to value is based upon the assumption that a property is worth the future income, discounted to present worth, that it will generate for a prospective buyer. The income approach is widely used in the valuation of various types of income producing properties; however, the approach has limited application in valuing properties that do not produce an income stream. Reserve coal and reserve other natural resource properties do not produce an income stream and do not therefore readily lend themselves to application of an income approach valuation.

MARKET APPROACH

The market approach to value is based upon the assumption that the recent selling price of comparable properties, if properly analyzed and adjusted, will yield a reasonable estimate of current market value. Consistent with the above referenced legislative regulations, the Department of Tax and Revenue developes a market comparable approach for reserve coal and reserve other mineral properties. The Department has reviewed sales from 1988 through 1996 in various fashions and has constructed measures of central tendency concerning sales transacted during the aforementioned period of time. These sales have been analyzed by regions established in CSR § 110-1I-4.1.9.2.c for reserve coal properties and CSR § 110-1K-4.2 for reserve other mineral properties. The Department maintained and published this survey of sales on May 31, 1996, August 19, 1996 and November 15, 1996, and filed modified final sales variables on July 1, 1996 for other minerals and December 9, 1996 for reserve coal.

For more information concerning the appraisal of reserve coal and reserve other mineral properties consult CSR § 110-1I-1 et seq. and CSR § 110-1K-1 et seq. or contact the Department of Tax and Revenue at telephone number (304) 558-3940.

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