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Bridging the Gap: Property Tax Advisors and Valuation Professionals in the Energy Industry & Recognizing & Quantifying Obsolescence – Case Studies

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Introduction

This presentation seeks to highlight the distinct roles of a property tax consultant and a valuation professional in ad valorem settings. And talk about EO, predominantly through case studies.

Property Tax Consultant

- Advocacy
- Tax Strategy
- Assessment Management
- Negotiation
- Tax Savings Focus

Appraiser

- Independence
- Value Analysis
- Support
- Methodology
- Credibility & Defensibility

Relationship and Bright-Line Roles

Property tax advisors and the appraiser serve complementary but separate and distinct roles.

The Advisor is a negotiator, strategist and advocate for their client.

The Appraiser is an independent expert and credibility anchor.

The Advisor and Appraiser share the common goal of supportable value conclusion.

The Appraiser can never advocate for their client.

Aggressive (but Credible)

WALKING THE TIGHT ROPE BETWEEN ADVOCACY AND CREDIBILITY

EFFECTIVE ADVOCACY REQUIRES BALANCING RELENTLESS PURSUIT OF CHALLENGING ASSUMPTIONS WHILE MAINTAINING TECHNICAL CREDIBILITY

CHALLENGE THE MODEL, NOT JUST THE NUMBER

Central Appraisal Districts ("CAD") often utilize mass appraisal techniques and valuation modeling for a "one size fits all" approach. Mass appraisals are useful when valuing assets or properties that share common characteristics.

The models for mass appraisals often overlook or understate the asset or company-specific valuation metrics that can significantly impact taxable value.

ATTACKING MASS APPRAISALS

Challenge Unsupported Assumptions

Scrutinize mass appraisal methodologies, replacement cost assumptions, cap rates, etc.

Credibility Gained Through Data/Industry Expertise

Create defensible valuation analysis, market evidence, engineering support dovetailed with knowledge of the industry

Balance Negotiations with Professionalism

Legitimize reduction opportunities with technical integrity with appraisal districts, ARB's, attorneys, etc.

MASS APPRAISAL FLAWS

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Overgeneralization of Unique Assets	Static Assumptions in a Dynamic Industry	Inaccurate Decline Curve Modeling	Misapplication of Discount Rates	Inadequate Recognition of Obsolescence	Cost Approach Distortions	Lack of Asset-Level Data Integration	"One Size Fits All" Capital Structure Assumptions	Incentive Bias Toward Administrative Efficiency

Mass appraisal models leverage efficiency over accuracy

Defining the Problem and Navigating the Issues

The Problem

The central challenge is often not valuation methodology but ALIGNMENT OF ASSUMPTIONS that materially drive value conclusions.

Property tax disputes often arise from differing interpretations of the same (or very similar) data sets, cost inputs, and units of measurement.

Clearly Defines Roles

The Consultant and Appraiser must have clarity on their roles through the process. **NEGOTIATIONS NEVER STOP!** The Consultant can negotiate in parallel to the Appraiser performing the analysis and issuing the report. The Appraiser should not be swayed by an outcome that is favorable to the Consultant.

Breakdowns occur when the lines are blurred between these two roles.

- Consultant taking on the role of the Appraiser or intentionally impacting the appraisal
- Appraiser neglecting to use a valuation approach that would be unfavorable for the Consultant or client (deliberate errors of omission)

Navigating the Issues Effectively

Correctly identifying valuation “pressure points” early in the process will yield better, more consistent results in late-stage defense of the analysis.

Continuous communication is key. The Consultant cannot simply hand over the process to the Appraiser. Likewise, the Appraiser must keep the Consultant informed of their key assumptions, drivers of value, and areas of contention to better position the Consultant in negotiations.

Common Areas of Disconnect

Purpose

The purpose of the assignment is often a major area of disconnect as the property tax consultant focuses on minimizing assessed values while the valuation professional is forming an unbiased opinion

Property Tax Consultant
- Vigorous advocation for taxpayer position
- Focus on "fairness" and jurisdictional consistency

Valuation Professional/Appraiser
- Objective, unbiased, and driven by technicals
- Operating within parameters of appraisal standards/methodology requirements
- Focus on "accuracy" and what is defensible

Definition of "Value"

Value definitions can dramatically shape the strategy for property tax consultants while appraisal professionals stress the importance of value irrespective of taxation.

Property Tax Consultant
- "What is taxable?" is almost top of mind
- Emphasis on potential exclusions, maximizing obsolescence, and statutory treatment
- Taxability just as (if not more) important than market value

Valuation Professional/Appraiser
- "What is the asset worth?" not what is taxable

APPRAISED MARKET VALUE DOES NOT ALWAYS EQUAL TAXABLE VALUE!

Treatment of Functional and Economic Obsolescence

Property tax consultants focus on maximizing leverage for obsolescence factors. This can be problematic for appraisers who are bound by professional standards and valuation methodology.

Property Tax Consultant
- Aggressive stances on underutilization, commodity price ripple effects, excess capacity, regulatory burdens, etc.

Valuation Professional/Appraiser
- Obsolescence identification and quantification grounded in evidence and measurable support
- Obsolescence tends to be applied conservatively

Highest and Best Use Assumptions

Assumptions pertaining to "highest and best use" can significantly impact value. For most property tax consultants, emphasizing potential "short term" impacts can be strategically advantageous, but can create issues for appraisers who take a more holistic view.

Property Tax Consultant
- Over-emphasis on current economic or inutility

Valuation Professional/Appraiser
- Often assume continued optimal use or stabilized/normalized operations

Reliance on Industry Operations

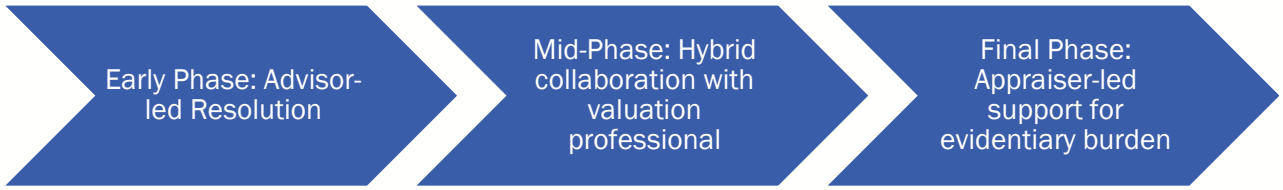
One of the primary objectives for a property tax consultant is taking operational realities and creating avenues that can lead to value reduction. Property tax consultants are not bound to use valuation models or benchmarks that normalize across market participants.

Property Tax Consultant
- Heavily focused on downtime, throughput volatility, decline curves, basin or regional competition, margin compression, financial distress, etc.

Valuation Professional/Appraiser
- Typically rely more on standardized valuation modeling, market participant realities, and long-term financial performance

Transition, Valuation and Litigation

Consultants are often faced with the decision to accept an unfavorable settlement offer from the taxing jurisdictions or continue the negotiating process through litigation. Positions taken by the Consultant can materially impact the credibility of the process. Appraisers are often brought in strategically to escalate the strategy laid out by the Consultant but are given autonomy to develop their own analysis.



Escalation is triggered by

1. Material difference between assessment value and inability to negotiate an agreeable settlement.
2. Adversarial positioning by taxing authorities (EX. not willing to negotiate in good faith)

Appraiser "Value Add"

1. The Appraiser almost only gets called in when there is a problem.
    a. Quantifies depreciation and obsolescence.
    b. Communicates their findings in a coherent narrative report.
    c. Withstands the rigors of deposition and testimony

Physical Depreciation- Loss in value or usefulness of a property due to the using up or expiration of its useful life caused by wear and tear, deterioration, exposure to various elements, physical stresses and similar factors.

Functional Obsolescence- A form of depreciation in which the loss in value or usefulness of a property is caused by the inefficiencies or inadequacies of the property itself when compared to a more efficient or less costly replacement property that new technology might allow.

Economic Obsolescence- A form of depreciation where the loss in value or usefulness of a property is caused by factors external to the property.

Appraiser “Value Add”- Economic Obsolescence

- Industry economics
- Availability of financing
- Loss of material or labor sources
- Passage of new legislation
- Changes in ordinances
- Increased cost of raw materials, labor or utilities (without offsetting increase in product price)
- Reduced demand for the product
- Increased competition
- Inflation or high interest rates

Appraiser “Value Add”- Economic Obsolescence

Once identifying that EO exists, oftentimes it becomes equally or even more difficult to quantify that EO:

- What is the source of the EO?
- How is the source of the EO typically measured?
- Is EO recognized and acknowledged in the scope of work?

It is essential for the appraiser to remain objective in the examination of underlying facts when measuring EO:

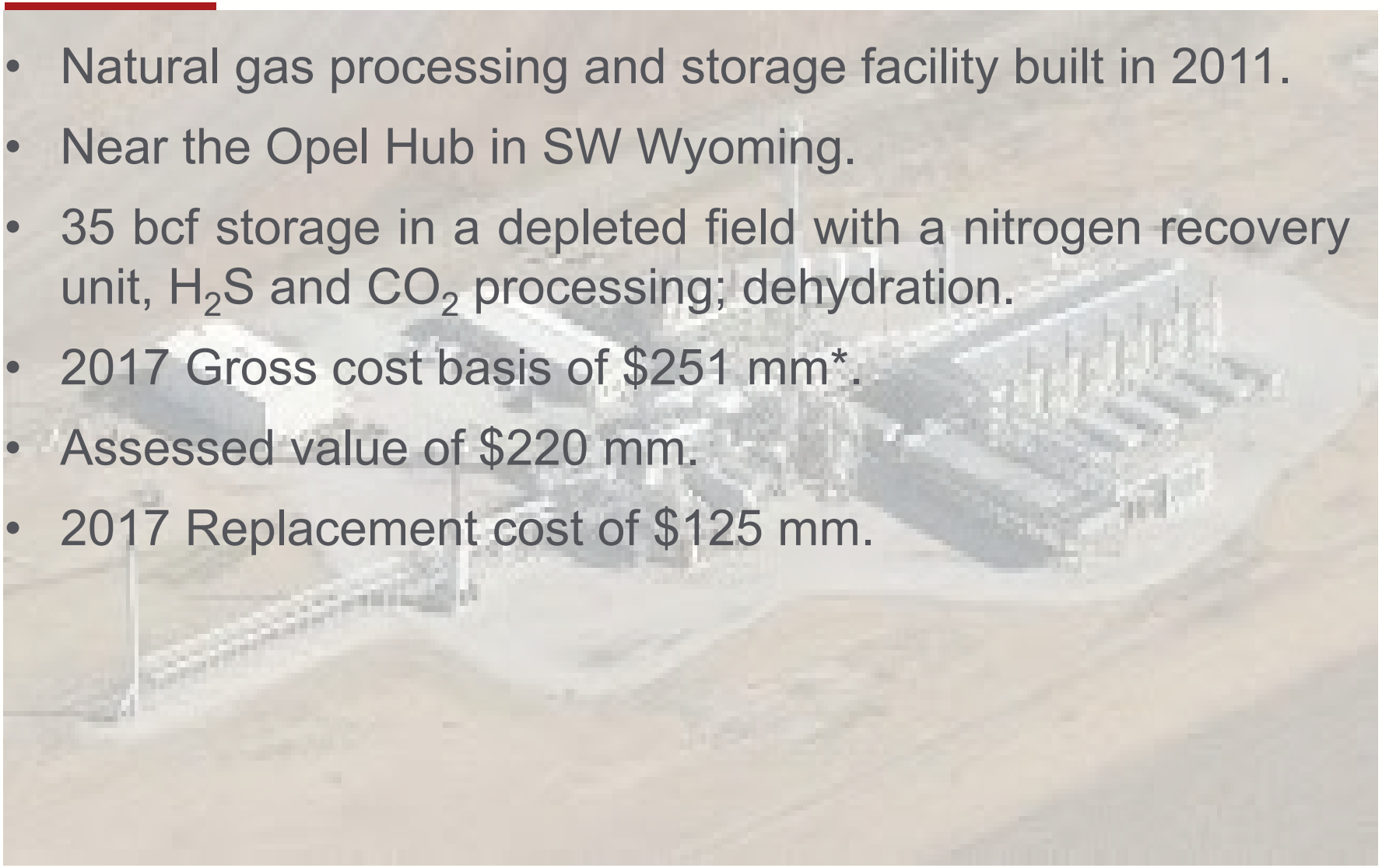
- Is the data analyzed to quantify EO directly relevant to the subject?
- Is the EO derived from a one-time, short-term occurrence?

Finally, care must be taken to apply appropriate analytical techniques and be certain to avoid double-counting the obsolescence.

Energy Sector Complexity and Case Studies

1. Midstream pipeline networks and allocation issues
2. Refining and petrochemical integration effects
3. Carbon capture/sequestration emerging valuation challenges
4. Rapid capital deployment and incomplete asset cycles
5. Regulatory and jurisdictional inconsistency

Case Study 1- Know Your Plant



- Natural gas processing and storage facility built in 2011.
- Near the Opel Hub in SW Wyoming.
- 35 bcf storage in a depleted field with a nitrogen recovery unit, H_2S and CO_2 processing; dehydration.
- 2017 Gross cost basis of $251 mm*.
- Assessed value of $220 mm.
- 2017 Replacement cost of $125 mm.

Case Study 1- Know Your Plant

- The plant was destroyed by a fire in 2013.
- Rebuilt and reopened in 2015.
- Client never took the “old” plant off their records double reporting the taxable basis.
- No quantification of functional or economic obsolescence by assessor when present and obvious.
- Concluded value of $57.3 mm.
- Testified twice.

- Settled at $90 mm.($220 mm originally)
- Bankruptcy at end of 2017.
- Company bought in 2018 for $26 mm + debt.

Takeaway- check your records

CASE STUDY 2

E&P

Saving an Oil & Gas Major Millions

CLIENT: A major oil and gas producer with assets in the Permian Basin engaged Merit, seeking to reduce its costs and tax liabilities.

CHALLENGE

Client sought ways to adjust 2020 assessments on its wells to reasonably reflect current market conditions. The client needed a resource that would work with appraisal districts and their representatives proactively to resolve valuation issues prior to public appeal hearings.

MERIT ACTION PLAN

- Worked with client to identify areas of the company's cost structure that might have been overlooked.
- Gained a thorough understanding of client's assets and operations to successfully act as the company's expert for negotiating property valuations.
- Provided all necessary data to appraisal districts to support valuation reductions and corrections.

RESULTS

$9.8M

ANNUAL CASH TAX SAVINGS

Merit Advisors

CASE STUDY 3

15+ Year Relationship with Large E&P and Midstream Company

CLIENT: A large E&P company with both upstream and midstream assets wanted a trusted service provider that would consider themselves an extension of the company and handle all property tax responsibilities.

CHALLENGE

Client with large asset base could not handle the property tax function in-house and needed a trusted advisor to partner with.

MERIT ACTION PLAN

- Assemble an experienced team utilizing state-of-the art technology to meet the client's best practices needs.
- Establish a culture of trust with the client with quarterly and annual meetings to discuss progress of tax department, upcoming issues, and successes.
- Trusted Advisor to the VP of Tax
- Deliver timely solutions to all company inquiries and perform all the property tax department duties responsibly.

RESULTS

$12.6B

VALUE REDUCTION

$208M saved in Ad Valorem tax

Merit Advisors

Case Study 3- Multifactor Analysis

1. Industry - Oil & Gas; offshore tools manufacturer

2. Subject assets - Inventory with a gross cost basis (“GCB”) of $235 million and BPP with a GCB of $225 million.

Case Study 3 Multifactor Analysis

What indicators are key to our client and subject assets?

	SLB	DRQ	NOV	TS	FET	GTLS	OIS	THR	Average
EBITDA margin									
Fiscal 2010	27.2%	30.8%	24.3%	25.3%	14.2%	13.1%	15.8%	28.2%	22.4%
Fiscal 2011	26.3%	26.2%	23.8%	24.1%	19.2%	15.0%	30.1%	16.8%	22.7%
Fiscal 2012	26.2%	25.6%	23.3%	26.5%	20.5%	15.5%	22.3%	26.1%	23.3%
Fiscal 2013	27.0%	29.0%	20.5%	26.4%	17.5%	15.0%	22.0%	24.9%	22.8%
Fiscal 2014	28.0%	33.3%	21.0%	26.6%	17.9%	15.5%	24.5%	27.4%	24.3%
Fiscal 2015	27.2%	32.8%	13.9%	17.7%	5.9%	12.4%	16.6%	22.5%	18.6%
Fiscal 2016	22.9%	27.7%	(10.2%)	13.9%	(11.1%)	11.8%	6.4%	16.4%	9.7%
Fiscal 2017	22.2%	7.2%	5.8%	17.8%	0.0%	11.6%	5.0%	17.9%	10.9%
Fiscal 2018	20.6%	1.0%	10.7%	20.4%	4.1%	13.0%	10.5%	19.7%	12.5%
Fiscal 2019	16.9%	9.1%	0.9%	18.5%	6.1%	12.8%	9.2%	17.5%	11.4%
Average	24.4%	22.3%	13.4%	21.7%	9.4%	13.6%	16.3%	21.7%	17.9%
Comparison to 2019	(30.9%)	(59.2%)	(93.4%)	(14.7%)	(34.8%)	(5.4%)	(43.2%)	(19.6%)	(36.2%)

Case Study 3- Multifactor Analysis

During our site inspection and discussions with Management it was revealed that certain Inventory assets were subject to new standards pertaining to structural integrity and testing for offshore equipment. The new standard was the fourth iteration of the American Petroleum Institute ("API") Standard 16A.

Metric	% Decline From Historical Average	Weight
U.S. offshore rig count	(35.2%)	60%
U.S. total rig count	(26.6%)	5%
Worldwide rig count	(20.3%)	5%
WTI pricing	(21.1%)	15%
Peer Group average EBITDA margin	(36.2%)	5%
Peer Group average inventory turnover	2.3%	5%
Peer Group average GMROI	(24.1%)	5%
		100%
Average	(23.0%)	
Median	(24.1%)	
Concluded	**(29.5%)**	

Gross carrying value	235,158,922
Burden (9%)	(21,164,303)
Net carrying value	213,994,619
API Edition 3 inventory	(68,125,653)
Obsolesence	(63,132,773)
Concluded value	82,736,193
Concluded value (rounded)	82,736,000
BPP (rounded)	42,000,000
Total	124,736,000

Takeaway-Ask Questions

WHAT MAKES A GOOD ADVISOR OR APPRAISER?

The consultant and the appraiser often approach the same asset (or assets) from very different perspectives – one through the lens of advocacy, the other through valuation

Property Tax Consultant

Mastery of Tax Law and Procedure

Must understand protests, equal and uniform arguments, exemptions, legal discovery, and jurisdiction-by-jurisdiction practices

Negotiation and Hearing Expertise

Ability to communicate and articulate highly technical valuation/economic concepts in front of appraisal districts, ARB's, attorneys, etc.

Industry Relationships

Real-time awareness of market conditions, operational upheaval, assessment trends, and new legislation

Results, Results, Results

Laser focus on measurable success, risk mitigation, and long-term client goals.

Valuation Professional/Advisor

Technical Expertise

Must possess strong understanding and applicability of the three approaches to value, specifically for complex or unique assets

Analytical Discipline/Rigor

Consistent application of the appropriate value techniques (EX. not relying on approach that will provide best results for rather the most credible outcome)

Interpreting Operational Data Objectively

Ability to evaluate and objectively analyze throughput, pricing volatility, capital requirements, etc.

Documentation and Supportability

Creating and maintaining workpapers, correspondence, market support, and other information utilized throughout the entirety of the valuation process

Future Trends in Energy Consulting and Valuation

1. Power generation, transmission and distribution
2. CCS
3. Continuation of exports
4. Refining capacity
5. Midstream/LNG expansions
6. Data centers
7. Hybrid asset valuation (renewables, battery storage, etc.)

Closing Thoughts

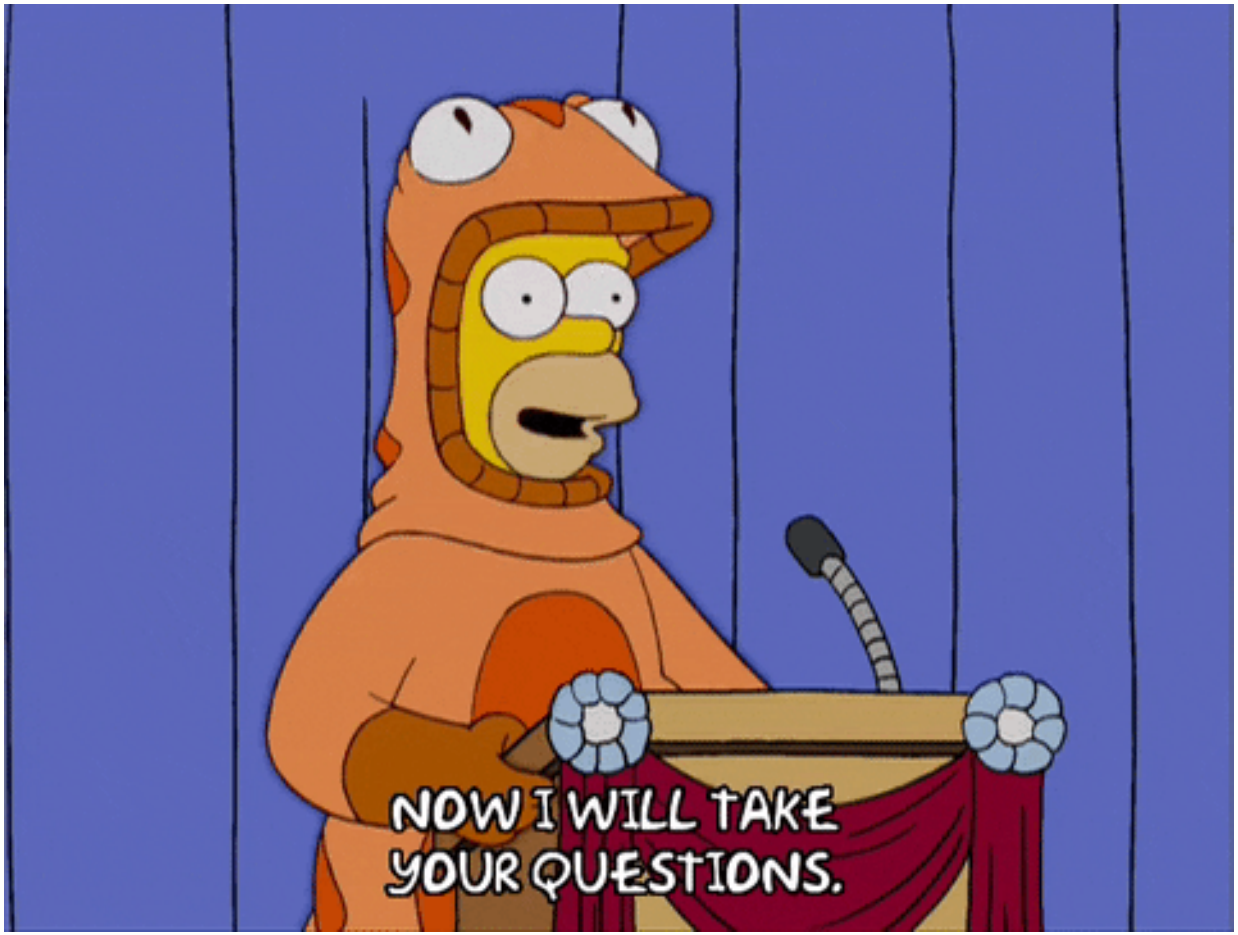
Appraiser-

1. Remember the line that exists between the advocate and the appraiser.
2. It is 100% correct to advocate for your conclusion of value in the proper setting.

Advisor-

1. Compensation often “results-based” such as a contingency (EX. 25 percent of tax savings to be paid upon successful negotiations)
2. Lower values by any reasonable (and sometimes not so reasonable) means. Advisor is not bound by USPAP. Job is to advocate vigorously on client’s behalf.

Questions?



Thanks!

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