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Trends in the Property Tax Valuation of Commercial Outdoor Advertising Structures

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The Cost Approach Is Becoming the Preferred Method for Ad Valorem Taxation of Billboards in Many Jurisdictions

OUTDOOR ADVERTISING STRUCTURES, or billboards, are complex properties, and their valuation for property tax purposes is a topic of interest for both taxing authorities and billboard owners and operators nationwide. In past years, the valuation discussion has been both academic and theoretical. Authors analyzed and sought to apply legal and appraisal theories in an attempt to discern how these structures should be categorized and assessed. This early discussion resulted in wide variances in assessed values due to the absence of uniform valuation practices in many states.

Recently, however, state taxing agencies and local assessors have taken definite positions on how to value these properties and a national trend has

emerged. In the administrative arena, fundamental decisions have been made on nearly all of the major issues.

This article focuses on the assessment of outdoor advertising in several states with large billboard populations. It also discusses the outdoor advertising industry, summarizes the major historical areas of contention, and analyzes the ad valorem assessment approaches now employed in leading states.

The Outdoor Advertising Industry

Although there is no definitive count, experts estimate that there are approximately 390,000 outdoor advertising structures nationwide.² Billboards are found in every state except Alaska, Hawaii, Maine and Vermont.³ Most outdoor advertising signs are located in metropolitan areas and along highways. These structures are generally owned by national or regional outdoor advertising companies.

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Billboard owners generate income by selling space for the dissemination of advertising messages. Billboards carry off-premise or off-site advertisements: that is, they disseminate commercial and non-commercial messages unrelated to the site on which the sign is located.

Aside from displaying their customers' messages, outdoor advertisers provide several other distinct services including: (a) identifying and obtaining sites for new signs, (b) marketing and sales development, (c) planning "showings" that meet advertisers' needs and budgets, (d) maintaining signs using a trained workforce which posts, removes or rotates displays, (e) maintaining performance records and, in some cases, (f) assisting with the advertising design and production of displays. In addition, some outdoor advertising companies provide services through other advertising mediums, which allows their clients to advertise through radio, television, and in print.

Outdoor Advertising Signs

Most outdoor advertising structures are supported by wood, steel I-beams or a steel monopole. They are also mounted on the sides or tops of buildings and in other locations, and they are often lighted. Billboards are found in a variety of locations and are generally built to standard dimensions using wood or steel. Perhaps the most common type of billboard is the large "bulletin" with a "face" or panel up to fourteen feet high and forty-eight feet wide mounted on one or more poles. The "poster" (12 feet high by 24 feet long) and the "junior poster" (6 feet high by 12 feet long) are also prevalent standards in the outdoor advertising industry. Though posters and junior posters still use them, in recent years, printed and painted displays on bulletins have been replaced by images printed on vinyl sheets which are stretched across the face of the sign structure.

Billboard owners typically lease the land upon which their billboards are

located. The lease is generally limited to an area large enough to accommodate the billboard and to allow for service and maintenance. Such ground leases are usually for a period of ten years. The great majority of these agreements provide for a flat rental amount per month, although some landowners negotiate percentage leases. Billboard ground leases normally contain clauses stating that the billboard situated on the land does not belong to the landowner. The standard ground lease also provides that the billboard owner or the tenant may terminate the lease with limited notice for specified reasons.

Billboard Advertising

Regional and national owners and operators of billboards often enter into standardized contracts with advertisers for advertising space (called a "showing") within a designated geographic market area for a specific period of time or for a group of specific sign locations. This occurs primarily in metropolitan markets, although within a metropolitan area the market may be segmented, which allows advertisers to market in a portion of a metropolitan area.

Advertising contracts between advertisers and billboard companies are either brokered by advertising agencies or solicited directly by billboard companies. The advertiser does not typically select the specific billboards on which its advertising message will be shown. Rather, the advertiser requests a particular level of exposure ranging from 25 to 100 Gross Rating Points ("GRPs"). Each GRP represents exposure of one percent of the population to the advertiser's message each day; for example, a "25 GRP showing" would mean that 25% of the population is exposed to the advertiser's message daily. A "showing" is based, in part, on measurement data given to individual signs by the Traffic Audit Bureau for Media Management ("TAB"). This measurement data is determined through analysis of traffic counts, population, and other information.

Billboard companies generally assemble multi-sign packages of billboards (from six to thirty or more “faces”) in the desired geographic region to satisfy an advertiser’s GRP requirements (which may include rotating the advertiser’s message among a variety of different signs). The agreement between an advertiser and billboard company will be for a package of billboards, usually for a period of weeks or months.

Assessment and Valuation of Billboards

When a billboard property is subject to *ad valorem* property tax assessment, any of the accepted approaches to value, income, sales, or cost, may be used. In the past, there has been disagreement, however, about which method or methods should be applied. Given the unique character of billboard property⁴ and outdoor advertising industry practices, a method was needed that accurately reflected the value of the *tangible taxable property* while avoiding the inclusion of related intangible assets and rights (*e.g.*, permits and advertising contracts), most of which are specifically exempt from property taxation in many states.⁵

Income Approach

While outdoor advertising structures are purchased for their capacity to generate income, it is difficult to identify the income solely attributable to the tangible taxable property (*i.e.*, structure), particularly since advertising income is generated, in large part, by permits, advertising contracts and other non-taxable intangibles. Assigning an exact worth to an individual billboard is also a challenge because advertisers often purchase showings on multiple billboards. In addition, where the owner of the billboard structure differs from the owner of the land underlying the structure, further difficulties arise in segregating income attributable to the structure from income generated by the land on which

the structure is situated. Consequently, in order to employ an income approach to value billboards, an appraiser must find a way to properly assign value to an individual billboard, to effectively eliminate the value attributable to non-taxable intangibles, and to segregate total value between the structure and the land. In most cases, it is not possible to use an income approach in a way which satisfies these multiple concerns.

Sales Approach

The concerns stated above apply equally to use of the sales approach to value billboards. A sale of a sign structure will likely include intangible assets which will need to be extricated from the sale price. If the sale was for both the structure and land, the sale price may need to be allocated between these two types of property. In addition, most billboard sales include more than one sign, which necessitates allocating a total purchase price among individual structures. Add to this the fact that billboard sale prices usually rely on the advertising revenues that multiple sign showings may generate (revenues which include returns to tangible and intangible assets), and the complexity and difficulty of using the sales approach or a sales price becomes obvious. When an appraisal using sales of *other* billboards as comparables is contemplated, the problems are further multiplied. Application of the sales approach is fraught with numerous difficulties, all of which militate against use of this approach for property tax valuation of billboards.

Cost Approach

The cost approach is the most suitable method for valuing billboards as it avoids nearly all of the pitfalls inherent in the other valuation approaches. First, the cost approach ignores the income generated by a sign or group of signs, and thus avoids including in a billboard’s value any increment of value attributable to income generated by nontaxable intan-

gible assets and rights associated with the billboard or a group of billboards. In the same vein, the cost approach does not consider the “synergy” value created by multiple billboards, but looks to the reproduction or replacement cost for each individual advertising structure. Because the cost approach focuses on valuing the individual sign structure and avoids inclusion of intangibles which are inherent in billboard revenues and billboard sales (e.g., permits and advertising contracts), it is the best way of determining value for the *ad valorem* taxation of outdoor advertising structures.

Cost Approach Elements

The key elements for application of the cost approach are (1) cost new and (2) depreciation. Cost new is usually based on reproduction or replacement cost, and can be determined by analyzing actual construction costs or construction cost indices developed by recognized costing services. Depreciation includes both typical wear-and-tear due to the age of a sign structure as well as obsolescence caused by various sources such as an outdated sign structure or method of operation, changing traffic patterns or government regulation.

Billboard Assessment Practices in Major States

Several states have adopted regulations, or promulgated standards, for the property taxation of outdoor advertising structures. For the reasons stated previously, the taxing authority in each of these states has concluded that the cost approach is the most appropriate method for valuing billboards. Because most of these states have significant billboard populations, the practices in these states are indicative of a national trend in the valuation and assessment of billboards for property tax purposes.

California

Created in 1879 by a constitutional amendment, the California State Board

of Equalization (“CA SBE”) is charged with insuring uniformity in the assessment practices of California’s 58 county assessors. One of the many ways in which the CA SBE accomplishes this is by issuing guidance publications to county assessors and taxpayers. These statements do not have the force of law, but are generally considered to carry “great weight.”⁶

In May 2002, in response to lack of uniformity in assessments and a growing number of local property tax appeals, the CA SBE began the process of establishing guidelines for the assessment of billboards. Industry representatives, local assessors, and CA SBE staff met informally to draft guidelines for billboard assessments. After several meetings over a six month period and a formal hearing, “Guidelines for the Assessment of Billboard Properties” (“Guidelines”) were promulgated by the CA SBE on December 3, 2002.⁷

The majority of the Guidelines is dedicated to valuation.⁸ Three generally-accepted approaches to value were considered: the cost approach, the comparative sales approach (using a gross income multiplier), and the income approach (using direct capitalization with a sales-derived overall capitalization rate). Although the guidelines state that any of the three approaches theoretically could be used, the CA SBE determined that the appraiser should, in most cases, use the cost approach to value billboards for property tax purposes.

The cost approach was preferred because, of all the approaches, it excluded value relating to intangibles. In California, as in many states, intangibles are not taxable.⁹ The approach was also seen as administratively efficient. As noted earlier, it is often difficult to isolate the value of an individual billboard because billboards sell in groups and advertising is sold by demographic or market area. Under the Guidelines, a cost new value is given to the property, depreciation is subtracted, and the value of land is

determined (using comparable sales) and added.

Calculating the cost new requires consideration of both hard and soft costs. Hard construction costs for outdoor advertising signs (superstructure, foundation, and infrastructure) vary depending on size and location. Soft or indirect costs may include identification and procurement costs. These vary from sign to sign and by locality. There is also a requirement that the costs reflect typical hard and soft costs.¹⁰

After estimating cost new, the Guidelines instruct that the billboard be depreciated. This is done using the depreciation schedule for machinery and equipment published by the CA SBE. The Guidelines, however, do not indicate the expected life of a billboard and, as of this writing, this issue has not been resolved.

The Guidelines do not favor the sales approach because it is difficult to apply as billboards generally sell in groups. Although large numbers of billboards have sold either on the market or as a part of the sale of an entire billboard company, these “bulk” sales have not generally attributed value directly to the tangible property as those terms are understood in the property tax context. This problem is further complicated by the fact that outdoor advertising structures are usually sold in conjunction with assignments of leasehold estates or possessory interests, and not with the fee interest in the land on which they are situated.

In addition, the Guidelines note that serious and sometimes unquantifiable subjective adjustments must be made to comparable sales. This is because outdoor advertising companies buy and sell billboards based, at least in part, upon the amount of advertising that the signs generate. This income stream, however, represents a return on both the hard assets as well as value attributable to management and labor, advertising contracts, goodwill and other intangible assets and rights which are not taxable.

The Guidelines warn that gross income multipliers should only be used when the reported sale is very similar to the subject billboard property, and the reported sale must be adjusted in order to make it closely comparable to the subject billboard property in terms of income potential, expense ratios, location and physical characteristics. When it is used, many adjustments should be made, including removing the value attributable to non-billboard assets, and intangible assets and rights.

Finally, the income approach was disfavored in the Guidelines because the majority of advertising is sold based on showings. When a showing is sold, there is not an allocation of income to a particular billboard. Because of this, it is difficult to get accurate data on an individual billboard. If an income approach is used, the Guidelines indicate that rental income is preferred to operating income, since operating income relates to intangibles and other non-taxable property (*e.g.*, advertising contracts). Further, the Guidelines state that billboard advertising income is equivalent to operating income and should not be used.

Florida

The Florida Department of Revenue supervises county property appraisers to ensure that property is fairly and uniformly assessed at “just value.” The Department of Revenue and Florida courts interpret “just value” to mean the fair market value of property, the value it would bring in an open market sale between a willing buyer and a willing seller, neither obligated to complete the transaction. In December 2002, the director of the Department of Revenue received and concurred with the recommendations of a study on billboard appraisal done by the Florida Office of Program Policy Analysis and Governmental Accountability (“OPPAGA”).¹¹

Among recently completed OPPAGA projects is a special review entitled

“Property Appraisers Use Cost Approach to Value Billboards; Guidelines Need Updating.”¹² In the report, OPPAGA surveyed Florida’s counties to discover how just value is determined in their assessment of outdoor advertising structures. The agency determined that of Florida’s 67 counties, 66 counties used the replacement cost approach to assess billboards, rather than the income or sales approaches. The county appraisers stated among their reasons for using the cost approach that:

*[I]nformation on the sales prices of individual billboards is difficult to obtain. The value of billboards is often unknown because billboards are usually sold in groups so that the buyer can attain the desired amount of advertising coverage in a geographical area.*¹³

In addition, the appraisers used the cost approach because of difficulty in obtaining sales rate information.

The OPPAGA report also disclosed that, in applying the cost approach, Florida assessors use depreciation schedules with residual values to determine the value of outdoor advertising structures.¹⁴ Although there is some variation, the great majority of counties use a 20 year schedule with a 20% residual value. A minority of counties use a 10 year schedule and/or a 30% residual value. This depreciation method is consistent with a majority of states and Section 179 of the Internal Revenue Code.

Ohio

All the powers, duties and functions of the Ohio Department of Taxation are vested in a Tax Commissioner who is appointed by the Governor and confirmed by the Ohio Senate. The Tax Commissioner is responsible for, among other things, promulgating tax rules and regulations. In the performance of this duty, annual guidelines and other types of advice are published. While these administrative interpretations are not law, they are given deference by the courts.¹⁵

The Ohio Department of Taxation annually issue a booklet entitled “Guidelines for Filing Ohio Personal Property Tax Returns” (“Ohio Guidelines”).¹⁶ The purpose of the booklet is to apprise the public of the manner in which personal property taxes are levied in Ohio. The Ohio Guidelines indicate both what is personal property and how to value it for tax purposes using designated classifications and corresponding depreciation schedules. In the 2003 edition of the Ohio Guidelines, as in earlier editions, outdoor advertising signs are designated as personal property. The tax on personal property is calculated using “true value.” The true value system has been used for more than 60 years and has repeatedly been approved by the Ohio courts. True value accepts as prima facie evidence the value that is determined by calculating book cost less depreciation. This value is used unless evidence to the contrary is brought by the Tax Commissioner or taxpayer to show that the depreciated book value is greater or less than the true value of such property.

As a part of the true value determination, the class of a particular type of property must be determined. Each class of property is valued using a different depreciation schedule. The Ohio Guidelines categorize outdoor advertising signs as a Class II property: Machinery and Equipment Used in Manufacturing. Under Class II, billboards are depreciated over 10 years and have a 20% residual value.

Texas and North Carolina

Texas law gives the State Comptroller’s Office the authority to advise local governments on property tax issues. In carrying out that duty, the Comptroller publishes appraisal manuals and other administrative materials. Among those materials is a Field Appraisal Manual, published annually.

For a number of years, the Texas Comptroller’s Field Appraisal Manual (“Manual”) has included a special bill-

board valuation section.¹⁷ The stated purpose of the Manual is to improve efficiency and consistency in county appraisals. The Manual's billboard valuation section was taken, almost verbatim, from the North Carolina Department of Revenue's Billboard Valuation Guide ("Guide").¹⁸ North Carolina originally developed the Guide in 1988 through a collaborative effort among industry representatives, property appraisers, and North Carolina Department of Revenue staff. As such, North Carolina was an early leader in the property tax assessment of outdoor advertising structures.

In its introduction, the Guide discusses some of the inherent difficulties in appraising billboards including "determining the owner of the real property, where the sign is located, as well as various terms, etc., of ground leases." For this reason, the Guide states that billboards are personal property.

According to the Guide, outdoor advertising signs are valued using the replacement cost new approach. The Guide, however, differs from the majority of states in that it determines replacement cost based on tables and charts rather than historical cost multiplied by a factor. For instance, the Guide determines the class of the billboard by the size of the face. Each billboard class is costed out at a different price per square foot. There are also adjustments for such things as the sign's height above ground, whether it is lighted, and other aspects of its construction.

Sign values are determined by calculating the replacement cost new and then depreciating the cost. Wood signs are depreciated over 20 years, while metal signs are depreciated over 40 years. In either case, the Guide provides for a 35% residual value. The Guide also provides that functional obsolescence, physical deterioration, and external obsolescence must be measured and factored into the final value. In addition, residual value is mitigated by adjustments that are left to the judgment of the local appraiser.

Wisconsin

The Wisconsin Department of Revenue oversees the collection of local taxes. The Department of Revenue has four major roles in property tax assessment. Among those roles are establishing local standards, equalizing values and ensuring local assessment compliance.

In Wisconsin, there are seven classes of real property and four classes of personal property. Assessors are required to segregate property into one of these classes. Outdoor advertising signs are, for property tax purposes, categorized in a miscellaneous personal property category called "all other personal property," although one Department of Revenue publication refers to billboards as "items classified as personal property for various reasons, but have similarities to real property."¹⁹

A Statement of Personal Property must be filed annually by property owners. As a part of that filing, the taxpayer declares the value of a billboard. The taxpayer is told to use Department of Revenue publications that depreciate billboards over 10 years using a minimum percent good, or residual value, of 13.2%.²⁰

Conclusion

Because intangibles are exempt from taxation in most states, the emerging trend in assessment practice is to use the cost approach. None of the jurisdictions with large billboard populations have put into practice a system that suggests any other approach would be acceptable. In fact, many states have warned that income and the comparative sales approaches tend to include intangible value and fail to overcome problems caused by analyzing advertising revenues generated by multiple billboards. In short, other methods are inefficient.

In applying the cost approach, almost all leading jurisdictions call for use of a cost new based on actual construction costs, either as reported by the billboard owner or using construction cost

indices. In addition, states with larger billboard populations use straight line depreciation. Billboard lifetimes and the minimum percent good figures fall within fairly narrow ranges. North Carolina and Texas have adopted a split approach, using 20 years for wood and 40 years for steel. A few other states have used 10 year trend tables. The great majority of states, however, and the Internal Revenue Code, give billboards a 20 year life. Most states have also concluded that 20% is a reasonable estimate of residual value.

The preceding survey of the states with the largest billboard populations demonstrates several emerging trends. Most notably, the cost approach is gaining broad acceptance. In addition, most outdoor advertising structures are assessed using straight-line depreciation over a 20 year life, and are assigned a 20% minimum percent good or residual value.

References

1. See generally, Sutte, D., *Appraisal of Outdoor Advertising Signs*, American Institute of Real Estate Appraisers, 1972; Floyd, C., "Issues in the Appraisal of Outdoor Advertising Signs," *The Appraisal Journal* (July 1983), p. 422; Sutte, D., *The Appraisal of Outdoor Advertising Signs*, Appraisal Institute, 1994.
2. Outdoor Advertising Association of America, "Number of Outdoor Displays/Vehicles" (2003) (available online at: <<http://www.oaaa.org/outdoor/facts/number2002.asp>>).
3. Fennessy, "Why Aren't Texas Highways Scenic? It's the Billboards," *Montgomery County News* (January 22, 2003) (available online at: <<http://www.montgomery-countynews.net/walden01-22-03.htm>>); Editorial, "Checking the Burgeoning Billboards," *Tampa Bay Tribune* (Aug. 31, 1998) (available online at: <<http://www.scenicflorida.org/pubs/bbed-burgeoning.html>>); Scenic America, "The Highway Beautification Act: A Broken Law" (a series available online at: <<http://www.ewg.org/reports/billboards/billboards.html>>).
4. An outdoor advertising structure can be classified as either personal property or real property. Academics and commentators have attempted to sort out the answer by applying definitions from the Appraisal Institute or state law. *The Appraisal of Real Estate*, 11th ed., discusses the difference between real property and a trade fixture (business personal property):
Although fixtures are real estate, trade fixtures are not. A trade fixture, also called a chattel fixture, is an article that is owned and attached to a rented space or building by a tenant and used in conducting a business. Trade fixtures are not real estate endowed with the rights of real property ownership. They are personal property regardless of how they are affixed.
- (Appraisal Institute, *The Appraisal of Real Estate*, 11th ed., Appraisal Institute, 1996, p. 9.) In analyzing the above definition, there are three criteria used: (1) the manner in which the item is affixed, (2) the character of the item and its adaptation to the real estate, (3) and the intention of the party who attached the item. However, because these definitions are relatively subjective and broad, the classification tests have proven inconclusive. Further, in recent years, the classification of billboards as either personal or real property has not been the primary issue in how they are to be valued in most jurisdictions.
5. Washington Department of Revenue, Property Tax Exemption of Intangible Assets (December 2000); Steele and Silverstein, *BNA Tax Management*, "Property Taxes: The Exemption for Intangibles."
6. *Yamaha Corp. of America v. State Board of Equalization* (Ct. Appeal Calif., 1999) 73 Cal.App.4th 338, 344-45.
7. Cal. State Bd. of Equalization, Letter to Assessors No. 2002/78 (Dec. 3, 2002)

(available online at: <<http://www.boe.ca.gov/proptaxes/pdf/lta02078.pdf>>).

8. The Guidelines do, however, consider the classification of billboards, which are categorized as fixtures, a subset of real property under California property tax law. The CA SBE reasoned that billboards were fixtures because billboards were affixed to the ground, moved infrequently, and were intended to remain annexed to the land indefinitely.

9. See endnote 5; California Revenue & Taxation Code, §§ 110(d)-(f) & 212.

10. Cal. State Bd. of Equalization, Letter to Assessors No. 2002/78 (Dec. 3, 2002), p. 3 (available online at: <<http://www.boe.ca.gov/proptaxes/pdf/lta02078.pdf>>).

11. Created in 1994, the Florida OPPAGA was established to provide objective, independent, professional analyses of state policies and services to assist the Florida Legislature. It helps the legislature with decision-making and ensures government accountability. The OPPAGA produces a variety of work products.

12. OPPAGA, Report No. 02-69, "Property Appraisers Use Cost Approach to Value Billboards; Guidelines Need Updating" (December 2002).

13. See endnote 12.

14. Residual value is the value which remains after a billboard is fully depreciated using a depreciation table. Residual values arise because depreciation tables do not go to 100% when a billboard reaches its maximum useful life.

15. *McCormack v. Limbach*, 1988 Ohio App.. LEXIS 348 (Ohio Ct. App. February 4, 1988, Decided); Ohio Revenue Code, § 5715.01.

16. Ohio Department of Taxation, "Guidelines for Filing Ohio Personal Property Tax Returns" (January 2003).

17. Texas Comptroller, "Field Appraisal Manual" (2002) (available online at: <<http://www.window.state.tx.us/tax-info/proptax/proptax.html>>).

18. North Carolina Department of Revenue, "Billboard Valuation Guide" (2001); See also, Wagner, J. and D. Baker, "The Valuation of Outdoor Advertising Structures: A Mass Appraisal Approach," *Assessment Digest*, vol. 14, no. 4 (July/August 1991), p. 2.

19. Wisconsin Legislative Fiscal Bureau, "Study of the Treatment of Personal Property Under the Property Tax" (September 2002), p. 16.

20. Wisconsin Department of Revenue, "Statement of Personal Property" (2004).

