

PROPERTY TAX NEUTRALITY METHODOLOGY

INTRODUCTION

The Settlement Agreement¹ and Stipulation² that established the Land Conservation Commitment require that the Land Conservation Plan being developed by the Stewardship Council provide property tax revenue, other equivalent revenue source, or a lump sum payment, so that the totality of dispositions in each affected county will be “tax neutral” for each county. Section 4.3 of Volume I of the Land Conservation Plan (LCP) adopted by the Stewardship Council in November 2007 described the Stewardship Council’s potential strategies and anticipated approach to achieving property tax neutrality at a programmatic level.

More recently, on September 17, 2009, the Stewardship Council adopted a funding policy. This policy further clarified the Stewardship Council’s approach to property tax neutrality and identified several potential vehicles to achieving this requirement. On March 30, 2011, the Stewardship Council adopted a set of guidelines which describe scenarios in which the Stewardship Council will make property tax payments to affected counties and further defined a set of overarching assumptions regarding property tax neutrality payments.

Table 1 below lists the estimated acreage and annual property taxes associated with PG&E watershed lands which are available for donation as of September 2011. The estimated total tax liability that would be subject to tax neutrality will depend upon the total acreage transferred, and the types of organization receiving lands.

COUNTY	Total Acres	Total Taxes (\$)	Acres Available for Donation	Taxes on Lands Avail. (\$)
Alpine	1,983	\$26,995	965	\$6,449
Amador	4,891	\$45,916	3,238	\$25,493
Butte	8,029	\$75,706	6,449	\$55,539
Calaveras	318	\$2,699	230	\$1,643
Fresno	1,527	\$26,917	342	\$3,552
Kern	664	\$1,734	0	\$0
Lake	5,271	\$116,467	3,355	\$80,975

¹ *Opinion Modifying the Proposed Settlement Agreement of Pacific Gas & Electric Company, PG&E Corporation and the Commission Staff, and Approving the Modified Settlement Agreement*, December 18, 2003:

http://www.stewardshipcouncil.org/documents/Settlement_Agreement.pdf

² *Stipulation Resolving Issues Regarding the Land Conservation Commitment*, September 25, 2003:

http://www.stewardshipcouncil.org/documents/Stipulation_Agreement.pdf

COUNTY	Total Acres	Total Taxes (\$)	Acres Available for Donation	Taxes on Lands Avail. (\$)
Madera	2,016	\$181,650	686	\$64,396
Mendocino	2,112	\$28,181	1,799	\$22,252
Nevada	10,651	\$107,895	4,889	\$39,128
Placer	7,846	\$356,996	5,587	\$179,825
Plumas	38,094	\$304,316	4,935	\$113,228
Shasta	46,989	\$296,123	36,191	\$178,510
Tehama	1,946	\$8,839	1,564	\$4,422
Tuolumne	1,840	\$28,470	1,040	\$11,368
Yuba	41	\$612	41	\$612
Grand Total	134,216	\$1,609,516	71,310	\$787,392

PURPOSE OF PROPOSED METHODOLOGY

The purpose of this methodology is to establish a standard payment process when lands are transferred to organizations that are exempt from paying property taxes. The following methodology will be applied to all counties which experience a loss in property tax revenues due to a recommended donation of fee title as part of the Stewardship Council's Land Conservation Commitment.

DETERMINING TAX NEUTRALITY PAYMENT AMOUNT

Following the Stewardship Council approval of a fee-title donation, the Stewardship Council will work with the affected county to calculate the payment amount for inclusion in the Stewardship Council's Land Conservation and Conveyance Plan (LCCP).

1. Using the legal description and/or survey of lands identified for transfer to an organization which is exempt from paying property taxes, the Stewardship Council and PG&E will prepare an estimate of the annual taxes on lands to be donated.
2. The reduction in annual taxes caused by the donation of acres to organizations exempt from property tax will constitute the "Annual Base Value" for the funding calculation.
3. The county will select either the lump-sum or annual payment option (described below) for the selected fee-title donation and communicate their preference in writing to the Stewardship Council. The county's selected option will be applied to all future fee title donations under the Land Conservation Commitment.
4. The Stewardship Council will provide a draft funding agreement for county review and approval using the Annual Base Value and payment option. The draft funding agreement

is expected to include, among other items, the following acknowledgements by the county:

- a. Payment by the Stewardship Council satisfies the tax neutrality requirement as specified in the Settlement and Stipulation for the subject fee-title donation.
 - b. The county has issued (or will not reasonably withhold) a Welfare Tax Exemption for the new landowner, if required.
 - c. The county will agree to distribute the lump-sum or annual payment to the applicable special districts as dictated in the relevant Tax Rate Area at the time of payment.
5. The executed funding agreement (which shall be duly accepted by the county via a certified board resolution) will be included in the Stewardship Council's Land Conservation and Conveyance Plan (LCCP). In turn, the LCCP will be attached to PG&E' Section 851 filing with the California Public Utilities Commission, wherein PG&E will seek regulatory approval of the proposed fee title donation. If assessed values on the lands recommended for donation change prior to the transfer of land, the Stewardship Council will revise the payment calculation and amend the funding agreement prior to transfer of lands.
6. Following the transfer of lands, the Stewardship Council will fund the settlement amount according to the terms of the funding agreement described in number 4 above.

OPTIONS FOR FUNDING PROPERTY TAX NEUTRALITY PAYMENTS

The Stewardship Council is presenting two options for making tax neutrality payments: (1) a one-time lump-sum payment; or, (2) funding of an independent trustee to continue annual payments in lieu of taxes.

Lump-sum payment

Lump-sum payments in satisfaction of property tax neutrality would be calculated based upon the net present value of the Annual Base Value at the time that lands are removed from the property tax rolls. The lump-sum payment will be calculated using a discounted cash flows analysis for perpetual payment streams, otherwise known as a Capitalization Rate (Cap Rate).

The Cap Rate calculation requires an assumption of a long-term rate of return on comparable investments, and a long-term inflation rate. In order to develop a Cap Rate for a lump-sum payment, the Stewardship Council considered multiple long-term inputs, including long term equity and fixed income returns (Dow Jones Industrial Average, S&P 500, U.S. Treasury, CalPERS), weighted average borrowing costs for subject counties, and discount rate assumptions for pension and other post-employment benefits.



Based upon the analysis described above, **the Stewardship Council is offering counties a Cap Rate of 4.0%** to be used in the calculation of a lump-sum payment in satisfaction of property tax neutrality. The calculation for arriving at a lump-sum payment is as follows:

$$\text{Lump Sum Value} = \text{Annual Base Value} \div 4.0\%$$

The following table provides an example of the application of the Cap Rate to various Annual Base Values:

Annual Base Value	\$500	\$1,000	\$5,000	\$10,000
Lump Sum at 4.0%	\$12,500	\$25,000	\$125,000	\$250,000

Lump-sum payments would be allocated based upon the applicable Tax Rate Area at the time of payment. The Stewardship Council envisions making these lump-sum payments as unrestricted payments in lieu of property taxes, subject to the distribution method described in section 4.c above. Counties and special districts would be free to determine the best use of the funds pursuant to the needs of the county or special district, including, if desired investment in a shared investment pool of the county's choosing.

Annual payments

The Stewardship Council is in negotiations with a professional investment manager to act as investment manager and trustee for an endowment to support the management and monitoring of conservation covenants after the Stewardship Council's anticipated dissolution in 2016. The Stewardship Council is prepared to make this arrangement available to counties which prefer to receive an annual payment in lieu of property taxes on lands which are removed from the tax rolls.

Under this structure, the Stewardship Council will make a contribution to an endowment account which would be designed to generate enough income to compensate for the lost property tax revenues and pay for annual investment management and trustee fees. The contribution to the endowment account would be calculated based upon the Annual Base Value for lands approved for donations and the expected payout ratio of 4%.

Annual payments out of the endowment account will be calculated based upon a rolling 20 quarter average of the account's ending balance³. The practice of calculating payments based upon a rolling average (smoothing) has been shown to reduce the number of significant declines in annual distributions, and increase the total value of payments and invested assets⁴.

³ During the initial four years, the trustee will calculate payments based upon the number of available quarters (e.g. year 1 – rolling 4 quarters, year 2 – rolling 8 quarters, etc.)

⁴ Smarter Giving for Private Foundations, AllianceBernstein, https://www.alliancebernstein.com/Research-Publications/Black-Books/Foundations-and-Endowments/Stories/Foundations_BlackBook.htm



Annual payments to counties would be allocated based upon the applicable Tax Rate Area at the time of payment by the receiving county. The Stewardship Council envisions making these annual payments as unrestricted payments in lieu of property taxes, subject to the distribution method described in section 4.c above. Counties and special districts would be free to determine the best use of the funds pursuant to the needs of the county or special district.

Participating counties would be enrolled in a common service model in the investment management account. All counties would share a common investment policy and investment management agreement. Funds will be invested in a commingled account, with the investment manager providing an individual accounting to each individual county.

Considerations of the Annual Payment Approach

The viability of the annual payment option is subject to a level of participation by the counties which meets the minimum account size (estimated at \$1 million).

Under this approach annual payments may exceed the original Annual Base Value in some years, and be lower in others, as the payment amount is reliant upon the ending market value of the account.

The Stewardship Council's transaction process is expected to occur serially, over the span of several years. It is likely that the viability and pricing of the annual payment approach will not be known for the initial transactions. Therefore, the Stewardship Council may make the initial annual payments directly to counties until the minimum account size is reached.

Please see [Appendix A](#) for a more details on the annual payment option.