

CHAPTER 106  
DETERMINATION OF VALUE OF RAILROAD COMPANIES

[Prior to 12/17/86, Revenue Department[730]]  
[Prior to 11/2/22, see Revenue Department[701] Ch 76]

Chapter rescission date pursuant to Iowa Code section 17A.7: 1/1/28

**701—106.1(434) Definitions of terms.**

**106.1(1)** The term “*railroad*” shall mean and include all individuals or corporations engaged in the operation of a railway in this state and subject to valuation pursuant to Iowa Code chapter 434.

**106.1(2)** The term “*unit value*” or “*unit market value*” shall mean the market value arrived at by using the appraisal method of valuing an entire operating property, considered as a whole and capable of performing the function for which it was created, such as (by way of illustration and not limitation) transporting freight over rail.

**106.1(3)** The term “*operating property*” shall mean all property owned by or leased to a railroad company, not otherwise taxed separately or made nontaxable by law, which is necessary to and without which the railroad could not perform the activities for which the railroad is formed, such as (by way of illustration and not limitation) transporting freight over rail. With regard to property whose identity as “operating” or “nonoperating” property is not clearly ascertainable, the property shall be considered operating property if the railroad could not reasonably be expected to perform the referenced activities in the absence of such property.

**106.1(4)** The term “*nonoperating property*” shall mean all property owned by a railroad not defined by subrule 76.1(3) as “operating property.”

**106.1(5)** The term “*comparable sales*” shall mean actual sales transactions, between willing buyers and willing sellers, neither being under any compulsion to buy or sell, of property which is similar in purpose, function and design to the property to which the comparison is being made. Where the determination of a unit value is being made, the sale of a portion of a unit which is nominally similar in purpose and function to the unit being valued shall not be considered a comparable sale, absent proof by evidence other than the terms of the sale itself, that the sales price was based on some unit of measurement which is common both to the property sold and the property being valued and which is not affected by the fact that less than the entire unit is being sold, such as (by way of illustration and not limitation) (1) the price per mile of track and (2) the price per square foot of the property.

**106.1(6)** The term “*income approach to unit value*” shall mean the estimate of unit market value obtained by dividing an appropriate income stream by an appropriate and compatible discount rate.

**106.1(7)** The term “*stock and debt approach to unit value*” shall mean the estimate of unit market value determined by combining the estimate of market value of the stock, debt, current liabilities, other liabilities, including capital leases, and deferred credits associated with the operating property of a railroad company.

**106.1(8)** The term “*cost approach to unit value*” shall mean the estimate of value determined by combining the original cost less a depreciation allowance for the operating property of a railroad company.

**106.1(9)** The term “*respondent*” shall include the railroad company whose property is to be valued.

**106.1(10)** The term “*leased assets*” shall mean capital leases.

**106.1(11)** The term “*original cost*” shall mean the actual cost of the property to its present owner, not the first cost at the time it was originally constructed and placed in service.

This rule is intended to implement Iowa Code chapter 434.

[Editorial change: IAC Supplement 11/2/22]

**701—106.2(434) Filing of annual reports.**

**106.2(1)** Annual reports required to be filed by the reporting railroad company shall be on forms prescribed and supplied by the department. It shall be the responsibility of the railroad company to obtain the forms supplied by the department.

**106.2(2)** Additional schedules or attachments submitted by respondent shall be identified as to subject matter, shall be typed on paper of similar size to that used in the annual report, and all data contained in the

schedules or attachments shall be adequately explained and documented as to source. When such additional schedules or attachments are submitted, they shall be considered part of the annual report.

**106.2(3)** The department of revenue may require the filing of additional information if deemed necessary. The request for additional information shall be answered completely and in accordance with instructions therein specified. Additional information required shall be considered part of the annual report.

This rule is intended to implement Iowa Code chapter 434.

[ARC 2657C, IAB 8/3/16, effective 9/7/16; Editorial change: IAC Supplement 11/2/22]

**701—106.3(434) Comparable sales.** Sale prices of comparable property in normal transactions shall be taken into consideration in arriving at its market value. In the event comparable sales are not available, the market value of operating property shall be determined by utilizing the three recognized unit approaches to value (i.e., stock and debt approach, income capitalization approach and the cost approach).

This rule is intended to implement Iowa Code section 434.15.

[Editorial change: IAC Supplement 11/2/22]

**701—106.4(434) Stock and debt approach to unit value.**

**106.4(1)** The stock and debt approach to unit value estimates the market value of the operating property by combining the market values of the common stock, preferred stock, debt, current liabilities, other liabilities, leases, and deferred credits associated with the operating property of the railroad company, on the basis that the market value of these items may be used as a surrogate for the market value of the operating property itself.

**106.4(2)** The market value of the long-term debt associated with the operating property shall be calculated by first determining a ratio, based on book values, whose numerator shall be the operating property and whose denominator shall be the total property of the railroad company. This ratio shall then be multiplied times the gross market value of the long-term debt and the result obtained shall be the market value of the long-term debt associated with the operating property.

The market value of publicly traded debt shall be determined by utilizing an average of the monthly high and low value of the debt for the 12 months preceding the valuation date. The values to be utilized shall be obtained by reference to any acceptable reporter of the market on which the securities are traded. If all or some of the securities are not publicly traded, the value of the securities shall be determined by appropriate comparable securities. The comparable securities shall be publicly traded and shall have a similar maturity date and coupon rate, as well as risk indicators similar to the untraded security. In each instance, the railroad company shall provide the department a statement of the market value of all securities and an explanation of how that market value was derived, including the identity of any comparable securities utilized. In the event that any utility is unable to utilize the foregoing rule to value its securities, it may provide the department with its own determination of the fair market value of its untraded securities together with a complete explanation of why the foregoing rule was not used and a detailed explanation of the method used.

**106.4(3)** The market value of the preferred stock associated with the operating property shall be calculated by first determining a ratio, based on book values, whose numerator shall be the operating property and whose denominator shall be the total property of the railroad company. This ratio shall then be multiplied times the gross market value of the preferred stock and the result obtained shall be the market value of the preferred stock associated with the operating property.

The market value of publicly traded shares of preferred stock shall be determined by utilizing an average of the monthly high and low value of the preferred stock for the 12 months preceding the valuation date. The values to be utilized shall be obtained by reference to any acceptable reporter of the market on which the preferred stock is traded. If all or some series of the preferred stock are not publicly traded, the value of such preferred stock shall be determined by appropriate comparable securities. The comparable securities shall be publicly traded and shall have the same or a similar dividend rate, as well as risk indicators similar to the untraded preferred stock. In each instance, the railroad company shall provide to the department a statement of the market value of its preferred stock and an explanation of how that market value was derived, including the identity of any comparable securities utilized. In the event that any railroad company is unable to utilize the foregoing rule to value its securities, it may provide the

department with its own determination of the fair market value of its untraded securities together with a complete explanation of why the foregoing rule was not used and a detailed explanation of the method used.

**106.4(4)** The market value of the common equity of a railroad company associated with the company's operating property shall be determined by capitalizing the income available to the common equity holders from the operating property, by an appropriate and compatible common equity return rate, all of which shall be determined as follows:

*a.* The calculation of the income to be capitalized shall begin with the railroad company's net income after taxes but before interest charges and preferred dividends for the 12-month period preceding the valuation date. The net income after taxes, but before interest charges and preferred dividends, shall be determined from the railroad company's regulatory report, or if no regulatory report is filed, from the audited financial statements of the railroad company. In the event the railroad company has no income or has a negative income, an alternative method shall be used to determine the market value of the common equity.

*b.* The income determined in 106.4(4) "a" shall be adjusted by deducting any net income included therein received from nonoperating property and, conversely, the referenced income shall be increased to account for any net loss created by any nonoperating property.

*c.* The income determined in 106.4(4) "a" shall be further reduced by that portion of the preferred dividends serviced by the income generated by the operating property, which shall be calculated by multiplying the total preferred dividend requirement by the ratio determined in 106.4(3).

*d.* The income determined in 106.4(4) "a" shall be further reduced by that portion of the debt service provided by the income generated by the operating property, which shall be calculated by multiplying the total debt service by the ratio determined in 106.4(2).

*e.* If there are any other interest payments required, a determination shall be made as to whether the underlying obligation was used to purchase operating or nonoperating assets. If no direct determination can be made, the interest payment shall be allocated in the same fashion as the debt service and preferred dividends. If the underlying obligation can be shown to be associated particularly, or in some specific proportion, to operating or nonoperating property, the interest payment shall be allocated either entirely or in such proportion to operating or nonoperating property. It shall be the obligation of the railroad company, in its reports to the department, to identify and detail any interest payments which are particularly associated with operating or nonoperating property, and if the railroad company fails to do so, the department may determine that all such payments may be allocated between operating and nonoperating property in the same ratio as is the debt service and preferred stock dividends (see subrules 106.4(2) and 106.4(3)).

*f.* Any extraordinary item affecting the income determined herein shall be eliminated in the calculation of the income shown under this rule.

*g.* The equity rate of return for the railroad company shall be determined by the use of the capital asset pricing model although where appropriate discounted cashflow models may be utilized as an alternative. Only in circumstances where these models are not able to be utilized will reliance be placed on a risk premium model or upon an earnings-price ratio, or other similar model, for determining the expected market rate of return on equity.

*h.* The income attributable to operating property available to the common equity holder as determined in 106.4(4) "a" to "f" shall then be divided by the equity rate as determined in 106.4(4) "g," and the result shall be the market value of the common equity associated with the operating property.

**106.4(5)** In the event the railroad company has entered into capital leases of operating property, the market value of the property leased shall be determined by calculating the net present value of the leases or net book value of the leases. The net present value shall be accomplished by discounting the future lease payments for each lease. The following is offered as an illustration of the calculation of such market value:

Length of Lease	Annual Lease Payments
1. Lease (a) 5 years	\$1,500,000
2. Lease (b) 7 years	\$ 800,000
3. Lease (c) 3 years	\$ 120,000

Net present value of leases (assuming 8 percent rate)		
Lease (a) =	$1,500,000 \div (1.08)^1 + 1,500,000 \div$	
	$(1.08)^2 \dots 1,500,000 \div (1.08)^5$	
Lease (b) =	$800,000 \div (1.08)^1 + 800,000 \div$	
	$(1.08)^2 \dots 800,000 \div (1.08)^7$	
Lease (c) =	$120,000 \div (1.08)^1 + 120,000 \div$	
	$(1.08)^2 \dots 120,000 \div (1.08)^3$	
Net Present Value of Lease (a)	=	\$ 5,989,065
Net Present Value of Lease (b)	=	\$ 4,165,096
Net Present Value of Lease (c)	=	<u>\$ 309,251</u>
Total Lease Values		\$10,463,412

The discount rate shall be equal to the railroad company's overall market debt rate of return.

**106.4(6)** In the event the railroad company has other sources of capital including, but not limited to, other liabilities, capital leases, and accumulated investment tax credits which cannot be identified as having been utilized to purchase specific assets, the market value of the sources of capital shall be allocated between operating and nonoperating assets in the same manner as long-term debt or preferred stock. Current liabilities and accumulated deferred income taxes are not to be included in this calculation. The book value of accumulated deferred income taxes should be deducted from the market value of the stock and debt approach before making this calculation. Likewise, current liabilities should be deducted from current assets and the resulting figure, if positive, should be added to the market value of the stock and debt approach and, if negative, should be deducted. The resulting figure, "net working capital," shall be allocated in the same manner as long-term debt or preferred stock (see subrules 106.4(2) and 106.4(3)). If any source of capital was created specifically for the purchase of property which can be identified as operating property or nonoperating property, the railroad company must identify the sources of capital in its annual report to the department, together with the appropriate evidence. If the railroad company fails to provide the information, the department may determine that the sources of capital may be allocated in the same manner as long-term debt or preferred stock (see subrules 106.4(2) and 106.4(3)). The market value of any source of capital, in the absence of evidence to the contrary submitted by the railroad with its annual report, shall be the book value.

**106.4(7)** The value determined by summing the portions of the enumerated sources of capital associated with the operating property of the railroad company provided in subrules 106.4(2) to 106.4(6) shall be the unit value of the operating properties determined by the stock and debt approach to unit value.

This rule is intended to implement Iowa Code section 434.15.

[Editorial change: IAC Supplement 11/2/22; Editorial change: IAC Supplement 10/18/23]

#### **701—106.5(434) Income capitalization approach to unit value.**

**106.5(1)** The income capitalization approach to unit value estimates the market value of the operating property by dividing the income stream generated by the operating assets by a market-derived capitalization rate based on the costs of the various sources of capital utilized or available for use to purchase the assets generating the income stream.

*a.* The net railway operating income to be capitalized shall be a weighted average net railway operating income. The weighted average net railway operating income shall consist of an average of the three 12-month periods immediately preceding the valuation date. Each of the three preceding 12-month periods shall be weighted by multiplying the first preceding period by 60 percent, the second preceding period by 30 percent, and the third preceding period by 10 percent. There shall be no adjustment for the company's current-year deferred income taxes to this income stream.

*b.* The department may also utilize a "free cash flow model" in calculating the railway operating income to be capitalized. The "free cash flow model" shall consist of an average of the five 12-month periods immediately preceding the valuation date. Each of the five preceding 12-month periods shall be given equal weighting in the calculation of the five-year average railway operating income to be capitalized. Each year the net railway operating income shall be adjusted by adding the current-year

deferred income taxes associated with maintenance expenditures, adding the current-year depreciation expense, and subtracting the current-year capital expenditures necessary to maintain the plant.

c. The department may give consideration to both calculations of operating income as described in this subrule to determine the railway operating income to be capitalized. The department may also consider, in both calculations, adjustments for extraordinary, unusual, and infrequent items. These adjustments would not be expected to occur annually and are different from the typical railroad business operations. The purpose and intent of the income indicator of value is to match income with sources of capital and therefore every source of capital utilized or available to be utilized to purchase assets should be reflected in the capitalization rate determination as well as all operating income. The department shall not include a separate adjustment to either income stream for noncapitalized operating leases. In the event the railroad company has no income or has a negative income, the indicator of value set forth in this subrule shall not be utilized.

**106.5(2)** If any operating property is clearly not income producing and, therefore, is not reflected in the income stream, the value of that asset shall be determined separately and added to the value of the other operating property as determined using the income indicator of value. The capitalization rate shall be adjusted, if necessary, for the market rate of return for the sources of capital utilized to purchase such non-income-producing properties where the sources can be clearly identified; otherwise the cost of the sources of capital shall be presumed to be equal to the overall market-weighted costs of the other sources of capital.

**106.5(3)** If the railroad company is one which can earn a return on assets purchased with sources of capital, excluding the company’s deferred income taxes, the income will reflect the earnings on those assets, and as a consequence, a separate adjustment to the capitalization rate is required. The capitalization rate shall be determined by utilizing, where appropriate, market rates of return weighted according to a market determined capital structure. All sources of capital shall be considered in the capital structure as well as market costs associated with each source of capital; otherwise the cost of the sources of capital shall be presumed to be equal to the overall market-weighted costs of the identified sources of capital. The following is an example of the application of this rule.

	(1)	(2)	(3)	(4)
	Market Value	Market Rate of Return	% to Total	Component (Col. 2 × Col. 3)
Common Stock	60,000	15%	66.67	10.00
Preferred Stock	5,000	13%	5.55	.72
Debt	25,000	12%	27.78	3.33
	90,000		100.00	14.05

This rule is intended to implement Iowa Code section 434.15.  
 [ARC 2657C, IAB 8/3/16, effective 9/7/16; Editorial change: IAC Supplement 11/2/22]

**701—106.6(434) Cost approach to unit value.** The cost approach to unit value shall be determined by combining the cost of the operating properties of the railroad and deducting therefrom an allowance for depreciation calculated on a straight-line basis. Other forms of depreciation may be deducted if found to exist.

This rule is intended to implement Iowa Code section 434.15.  
 [Editorial change: IAC Supplement 11/2/22]

**701—106.7(434) Correlation.** In making a final determination of value, the department shall give consideration to each of the methodologies described in these rules, the use of which will result in the determination of the fair and reasonable market value of the railroad company’s entire operating property. The stock and debt indicator of value and the income indicator of value shall each be weighted at 50 percent. In this particular circumstance, when the department utilizes the stock and debt indicator and the income indicator in the correlation process, the cost indicator will be given no weighting. If circumstances dictate that a particular method is inappropriate for a specific company, that method shall be given little or no weight in the final correlation of value.

This rule is intended to implement Iowa Code section 434.15.  
 [ARC 2657C, IAB 8/3/16, effective 9/7/16; Editorial change: IAC Supplement 11/2/22]

**701—106.8(434) Allocation of unit value to state.**

**106.8(1) *Allocation by the department.*** The department shall allocate that portion of the total unit value of the railroad company's operating property to the state of Iowa based on factors that are representative of the ratio that the railroad company's property and activity in the state of Iowa bear to the railroad company's total property and activity. These factors are:

- a. Gross operating revenue weighted 40 percent.
- b. All track mileage weighted 35 percent.
- c. Revenue traffic units weighted 15 percent.
- d. Car and locomotive mileage weighted 10 percent.

**106.8(2) *Alternative methods.*** In the event that the allocation prescribed by subrule 106.8(1) does not fairly and reasonably allocate unit value of the railroad company's operating property to the state of Iowa, the department shall consider such other factors as the department deems appropriate by the exercise of sound appraisal judgment.

This rule is intended to implement Iowa Code section 434.15.  
 [ARC 2657C, IAB 8/3/16, effective 9/7/16; Editorial change: IAC Supplement 11/2/22; Editorial change: IAC Supplement 10/18/23]

**701—106.9(434) Exclusions.**

**106.9(1)** From the estimate of value pursuant to rule 701—106.8(434), there shall be a deduction for pollution control property provided in Iowa Code section 427.1(32).

**106.9(2)** From the estimate of value pursuant to rule 701—106.8(434), there shall be a deduction for interstate bridges and other locally assessed property. Locally assessed property shall mean all property subject to an assessing authority pursuant to Iowa Code section 441.54. The respondent shall supply a schedule providing the actual value as determined by the local assessor on or nearest to the current assessment date.

**106.9(3)** From the estimate of value determined under rule 701—106.8(434), the value of Iowa personal property shall be deducted pursuant to Burlington Northern Railroad Company vs. Gerald D. Bair, Director of the Department of Revenue of Iowa—United States District Court Order-Civil No. 83-100-A. The computation for the percentage of personal property shall be equal to the ratio of the net book value of personal property divided by the net book value of the total property.

**106.9(4)** From the estimate of value determined under rule 701—106.7(434), the intangible value shall be deducted pursuant to Burlington Northern Railroad Company vs. Gerald D. Bair, Director of the Department of Revenue of Iowa—United States District Court Order No: 4-90CV-60406. The deduction shall be equal to 6.6 percent of the correlated system value for the stock and debt indicator and the income indicator.

This rule is intended to implement Iowa Code sections 427.1(32), 434.15 and 434.20.  
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<sup>1</sup> Effective date of Ch 76 delayed 70 days by the Administrative Rules Review Committee on 7/14/83.