701—107.5(428,433,437,438) Income capitalization approach to unit value.

107.5(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. The purpose and intent of the income indicator of value is to match income with sources of capital and, therefore, every source of capital used or available to be used to purchase assets should be reflected in the capitalization rate determination as well as all operating income.

The net operating income to be capitalized for pipeline companies shall be a weighted average net operating income. The weighted average net 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 three, the second preceding period by two, and the third preceding period by one. The income stream for pipeline companies shall be further reduced by deducting the current year net adjustment expense for investment tax credits.

If the utility company has no income or has a negative income, the indicator of value set forth in this subrule shall not be utilized.

If the utility company is one which is not allowed to earn a return on assets purchased with sources of capital such as the company's deferred income taxes, the income will not reflect the earnings on those assets, and as a consequence, a separate adjustment to the income indicator of value must be made to account for the value of those assets. In such instances, the income indicator of value shall be increased by an amount equal to the book value of the source of capital involved, such as the accumulated deferred income taxes. The adjustment to the income approach for accumulated deferred income taxes shall not be made for pipeline companies. If any other operating property is clearly not income producing and, therefore, 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 identified sources of capital.

107.5(2)   If the utility company is one which can earn a return on assets purchased with sources of capital such as 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, with the exception of deferred credits whose market value shall be equal to its value on the company's books and whose cost shall be zero. 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) Market Value	(2) Market Rate of Return	(3) % to Total	(4) Component (Col. 2 × Col. 3)
Common Stock	60,000	15%	62.50	9.38
Preferred Stock	5,000	13%	5.21	.68
Debt	25,000	12%	26.04	3.12
Deferred Credits	6,000	—0—	6.25	—0—
	96,000		100.00	13.18

This rule is intended to implement Iowa Code sections 428.29, 433.4, 437.6, 437.7, and 438.14.

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