EXH. A

Safeway, Inc.

All Santa Cruz County Locations

2017 Assessment Appeals

Applications
078-17
079-17
080-17
081-17
082-17
083-17

Account Numbers
07316-00-9
07318-00-3
07510-00-3
07314-00-5
07319-00-0
07315-00-2

Applicant's Representative
Brent Buskirk, Agent
Property Tax Assistance Co., Inc.
16600 Woodruff Ave.
Bellflower, CA 90706
(562) 920-1864

Narrative

Hearing Date 9/17/18

Exhibit A

Safeway, Inc.
Assessment Appeal Narrative

Summary

Safeway, Inc. is one of the largest food and drug retailers in North America. At year-end 2012, Safeway operated 1,641 stores in the United States and Canada.

Safeway operates stores ranging in size from approximately 5,900 square feet to over 90,000 square feet. The size of a store is determined based on a number of considerations, including the needs of the community the store serves, the location and site plan, and the estimated return on capital invested. Safeway's primary new store prototype is 55,000 square feet, and is designed to accommodate changing consumer needs and achieve operating efficiencies. Most stores offer a wide selection of food and general merchandise, and feature a variety of specialty departments such as bakery, delicatessen, floral, and pharmacy.

The Assessor's Office has valued Safeway's store equipment, fixtures, and décor using the cost approach to value. The applicant has also used the cost approach for its opinion of value. However, the applicant believes that the percent good factors used by the Assessor's Office to value the aforementioned equipment are incorrect. During this presentation, the applicant will prove that its application of the cost approach produces the best estimate of fair market value.

Issue: Depreciation

First, it is important to understand the difference between "average service life" and "physical life." Valuing Machinery and Equipment by the American Society of Appraisers (ASA) defines physical life as "the estimated number of years that a new property will physically endure before it deteriorates or fatigues to an unusable condition purely from physical causes, without considering the possibility of earlier retirement due to functional or economic obsolescence." Assessor's Handbook (AH) 504 defines physical life as "the time the equipment has existed." Conversely, AH 504 defines average service life as "the average life term of a group of items."

A study was conducted in the 1930s by Iowa State University that led to the development of 18 sets of curves illustrating the retirement frequency of different groups of equipment. Known as the "Iowa Curves," these curves became the basis of the depreciation factors used in the Assessor's annual cost approach. These 18 curves are divided into the "R," "S," and "L" categories based on the relationship between the modal year (the year with the highest frequency of retirements) and the average life of the equipment. The L curves have a modal year before the average service life, the S curves have a modal year equal to the average service life, and the R curves have a modal year past the average service life.

Of the five R curves from the Iowa State University study, the R3 curve was selected as the basis for the State Board of Equalization's (SBE) depreciation factors. Based on the R3 curve, it can be expected that approximately 54% of the equipment should retire after the average service life is achieved, and 46% will retire before. For example, if a 12 year average service life is in place, then one could expect that 54% of the equipment would be retired after 12 years of service, and a small percentage would last over 20 years. The physical life of individual pieces of equipment has no bearing on average service life.

The Assessor's Office has depreciated the majority of Safeway's personal property using the SBE 12-year average service life percent good factors. SBE provides percent good factors for average life ranging from 3 to 40 years. The appraiser has to make an appraisal judgment to decide which table to apply so that the application of these factors results in a proper fair market value. The appraiser in this case used judgment and applied the 12-year average service life percent good factors. By using the 12-year percent good factors, the Assessor's Office made the assumption that the bulk of the equipment will retire at an age between 12 and 15 years, and some equipment will last as long as 20 years.

The issue is not how long the equipment could physically last, but how much the equipment is worth after each year of use, and how many years before the equipment depreciates to a minimal value. The application of 12-year percent good factors resulted in the Assessor's Office valuing 5 year, 10 year, and 15 year old equipment at 66%, 35%, and 14% of its original acquisition cost, respectively.

The applicant used the SBE 8-year average service life percent good factors to calculate fair market value based on the following:

- Store equipment is turned over every 8-10 years, on average. Between major remodels, minor remodels are performed on an annual basis.
- Articles from various industry publications stating that remodels occur every 5-10 years
- Life expectancy guidelines from Marshall & Swift Valuation Service

Over the last 20 years, Safeway has undergone several remodeling cycles. The first began in 1997, the second in 2004, and the current cycle began in 2013. During these major remodels, approximately 70%-80% of equipment, fixtures, and décor is replaced due to functional and/or economic obsolescence. Safeway averages scrap value or less for most of its old equipment. Besides obsolescence, other reasons for remodeling include:

- Company policy to remodel after a certain number of years based on consumer demand
- Using more energy efficient equipment to reduce electricity consumption and/or comply with government regulations
- Changing demographics and tastes
- Anticipation or entrance of a new competitor
- Consumer demand for other services (i.e. Starbucks, Jamba Juice, etc.)
- Physical deterioration; high foot traffic leads to damaged equipment.

To determine a proper market value one must analyze the available data and arrive at a conclusion in conformity with applicable California laws and valuation principles. On average, the bulk of the equipment is replaced between 8-10 years, not 12-15 years as assumed by the Assessor's Office. Even after refurbishment of used equipment and adding dealer costs and profits, a used equipment dealer cannot sell 5-year, 10-year, and 15-year old equipment for 66%, 35%, and 14% of the equipment's historical acquisition costs as claimed by the Assessor's Office. The market data from Food Marketing Institute, Marshall & Swift, Safeway's store remodeling policy, and various information from industry publications indicate that the use of the SBE 8-year average service life percent good factors would provide a better estimate of market value for grocery store equipment.

Conclusion

In contrast to the applicant's research, the Assessor's Office has used the California Assessors' Association (CAA) recommended SBE 12-year average service life for grocery store equipment. Neither CAA nor SBE has provided documentation for the recommendation to use a 12-year average service life for this category of equipment. To the best of our knowledge, neither group has performed an economic life study to support using a 12-year table.

In 1996, SBE released a Letter to Assessors (LTA) discussing the guidelines for the economic lives assigned to each equipment category. The LTA states that the economic lives are "based on the knowledge and experience of ASD's auditor appraisers, opinions of assessors and their staffs, and information from various industry sources. In most cases they were not based on actual studies of the average service lives of any of the listed groups of equipment." The LTA also states that the guidelines are "not to be cited as an authority in assessment appeals hearings. An assessment appeals case should be decided by applying the appropriate property tax statutes, regulations, court rulings, and sound appraisal practice to the pertinent information available for the situation in dispute."

The Assessor's Office has not used any market indicators to arrive at its opinion of value, rather, it is relying solely on the depreciation table recommended by the CAA. The aforementioned LTA tells us that these recommended tables should not be cited as an authority in determining fair market value. Therefore, it is our opinion that the Assessor has no support for Safeway' enrolled values.

In closing, we request that the Board enroll the following values:

Address	Acct/Assmt No	Appeal No	Pers Prop	Fixtures	Opinion of Value
253 Mt Hermon Rd	07314-00-5	081-17	347,413	120,239	467,652
16 Rancho Del Mar	07318-00-3	079-17	581,971	206,516	788,486
6255 Graham Hill Rd	07319-00-0	082-17	234,448	79,974	314,421
117 Morrisey Blvd	07315-00-2	083-17	928,748	340,639	1,269,387
2720 41st Ave	07316-00-9	078-17	800,215	260,979	1,061,194
2010 Freedom Blvd	07510-00-3	080-17	532,008	255,883	787,891
			3,424,801	**1,264,230**	**4,689,032**