



Rural Municipalities of Alberta

# Summary of Changes to Depreciation

Assessment Model Review

August 2020



To date, most of the information RMA has provided to members related to the assessment model review has focused on the impacts of the proposed changes on municipal revenue in the first year of implementation. This information is based on the estimates of changes in the value of (and corresponding changes in tax revenue from) non-residential properties prepared based on data provided by the Government of Alberta.

For most municipalities, these projections are daunting. Even more concerning is that the changes specific to asset depreciation will have even more significant impacts beyond the first year of implementation. During the review process, RMA requested the detailed models forming the basis of each scenario, as well as the assessment data sets used to calculate the first-year impacts in an attempt to better understand the long-term ramifications of the proposed changes. To this point, the province has declined to provide this data.

Historically, many of the assets impacted by the review have been valued using a proxy for original construction cost set in 2005 through the *Construction Cost Reporting Guide* (CCRG) multiplied by cost adjustment factors in a table based on year of construction. The values are then further lowered based on either a set depreciation factor or a schedule of depreciation based on age of the asset.<sup>1</sup> Without the detailed assessment data required to model these changes (particularly the age of specific assets), RMA can only make general comments on the long-term effects of the proposed changes.

In an effort to offset this lack of data and assist members in better understanding how they may be impacted in the long-term, this brief focuses on explaining what RMA views as one of the most concerning aspects of the proposed changes: artificially reducing the value of M&E and linear assets through accelerated depreciation.

Below is a summary of the Government of Alberta's proposed changes to depreciation for three components of the assessment model:

- Linear assessment of wells
- Linear assessment of pipelines
- Machinery & equipment on well sites.<sup>2</sup>

Note that the document reflects changes proposed in scenario D, but all scenarios have similar or in some cases identical depreciation approaches.

---

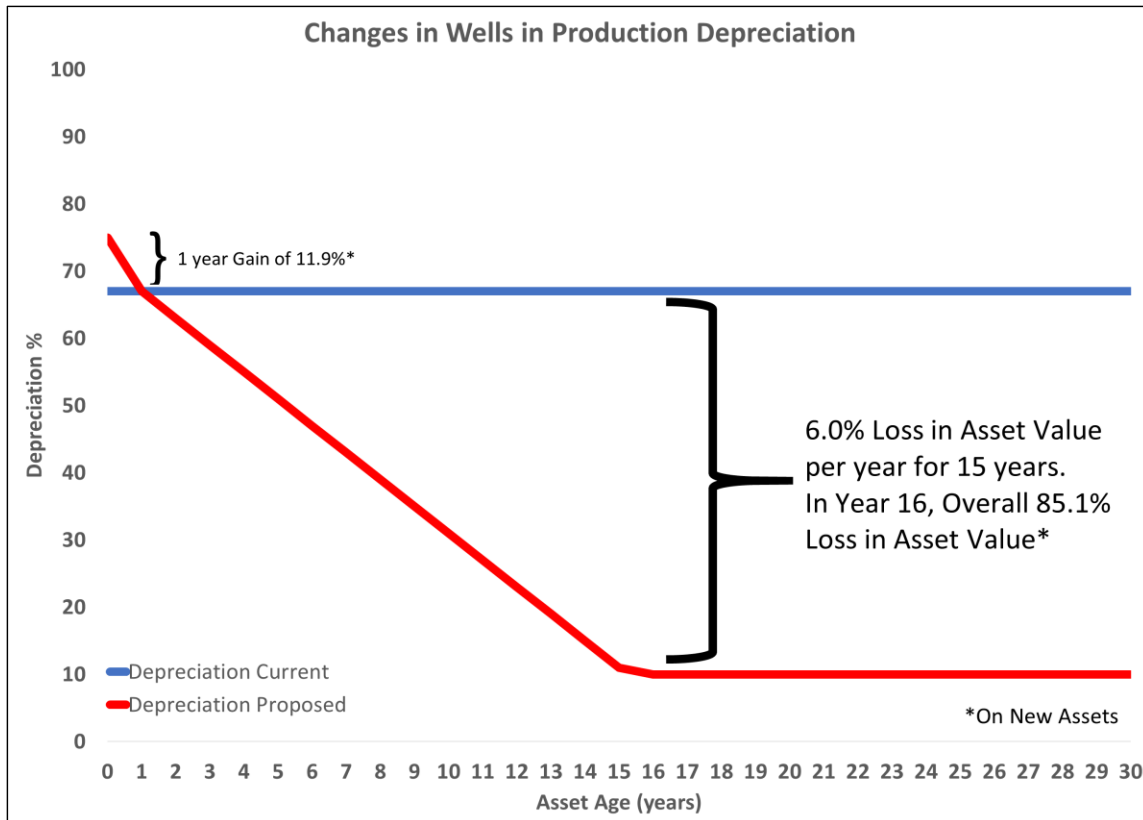
<sup>1</sup> Depreciation is calculated based on effective age of an asset, rather than its chronological age. Maintenance investment in the asset should increase or maintain an asset's effective life. Additional changes to assessment practices, including changes to reporting, or a reduction of in-person inspections could also have significant impacts on the depreciation of assets.

<sup>2</sup> It should be noted that all charts and examples provided are based on the proposed changes under Scenario D provided by MA. This is the most extreme alternative, in terms of impact in Year 1, but it is also the option being most strongly supported by industry advocates. In fact, the Canadian Association of Petroleum Producers (CAPP) has endorsed Scenario D, stating publicly that "no other option is acceptable."

# Linear Assessment of Wells

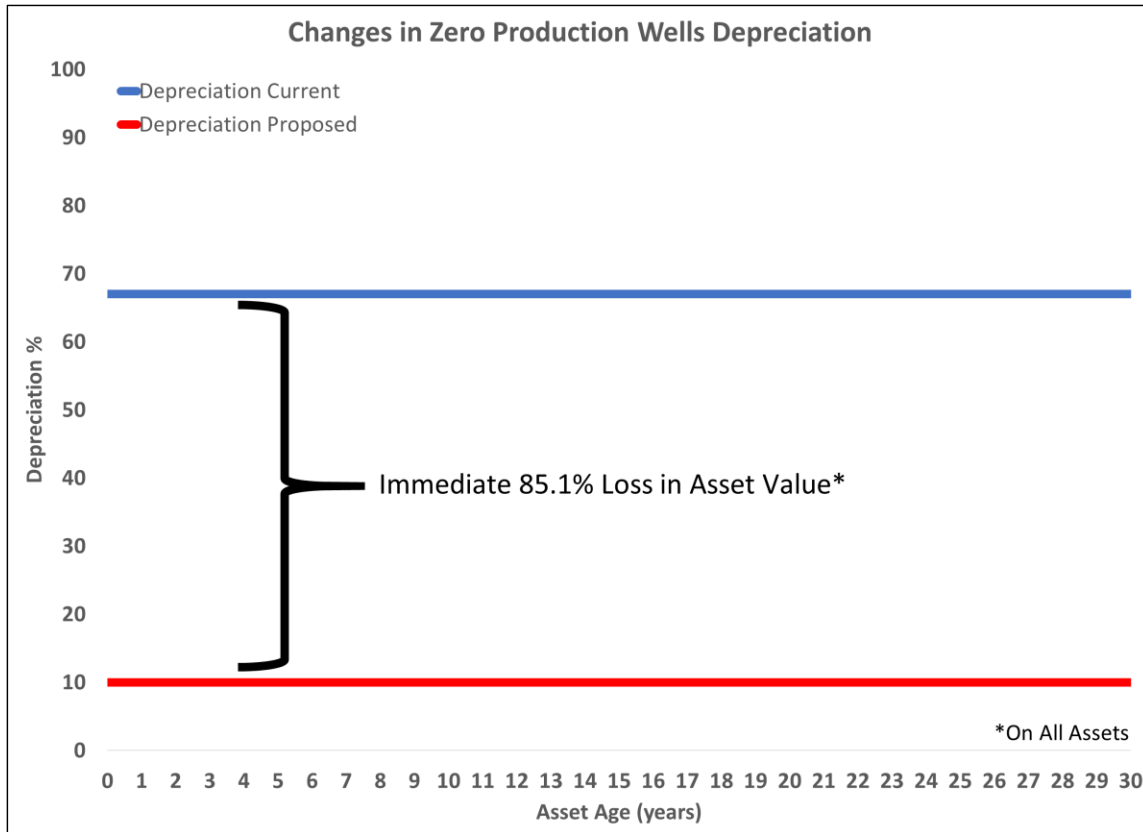
## Overview

All of the proposed scenarios introduce a straight-line model for depreciation of wells to replace the existing statutory factor of 0.67. The result is that rather than assessing a well based on a worth that is 67% of its construction cost (further adjusted with other factors) and maintaining that level for its life, depreciation will now be treated using a much more aggressive approach, which eventually results in the well being assessed at a value of 10% of its construction cost in 16 years.



After a brief assessment increase in the first year, the impact of this change is staggering, as the well would lose 85.1% of its asset value (compared to the current model) in 16 years.

An even more dramatic approach is proposed if the well goes out of production. It would immediately shift to 10% of its construction cost regardless of asset age.



### Change Summary

	Current Model	Scenario D
<b>Depreciation</b>	A set factor of 0.67 (67% asset value applied)	Begins at 25% and ends at 90%, and dropping 8% between year zero and year one, and by 4% per year thereafter until maximum depreciation (factor of 0.10) is reached in 16 years.
<b>Additional Depreciation</b>	Production	0.10 for zero production. Maximum depreciation is 0.10.
<b>Statutory Level or Adjustment Factor</b>		SAGD receives a 0.65 factor

### Example

A company has an operating five-year old well that after costing, assessment year modifier (AYM) and any special depreciation (ministerial prerogative) has a remaining value of \$30,000.

Under the current model, a standard 0.67 depreciation factor would be applied, allowing a municipality to apply their mill rate on \$20,100 of value. Under the new model, the straight-line depreciation would apply. This change would result in a factor of 0.51 for a five-year old well, making the value for taxation

purposes \$15,300; a significant but somewhat manageable drop in tax revenue of 23.5% (\$264 to \$201 in tax)<sup>3</sup> compared to a five-year old well under the current model.

However, if this new depreciation model is applied to a 16-year old well, the depreciation factor would be 0.10, reducing the taxable value to \$3000, resulting in a reduction in tax revenue of 85% (\$264 to \$39) compared to the current model.

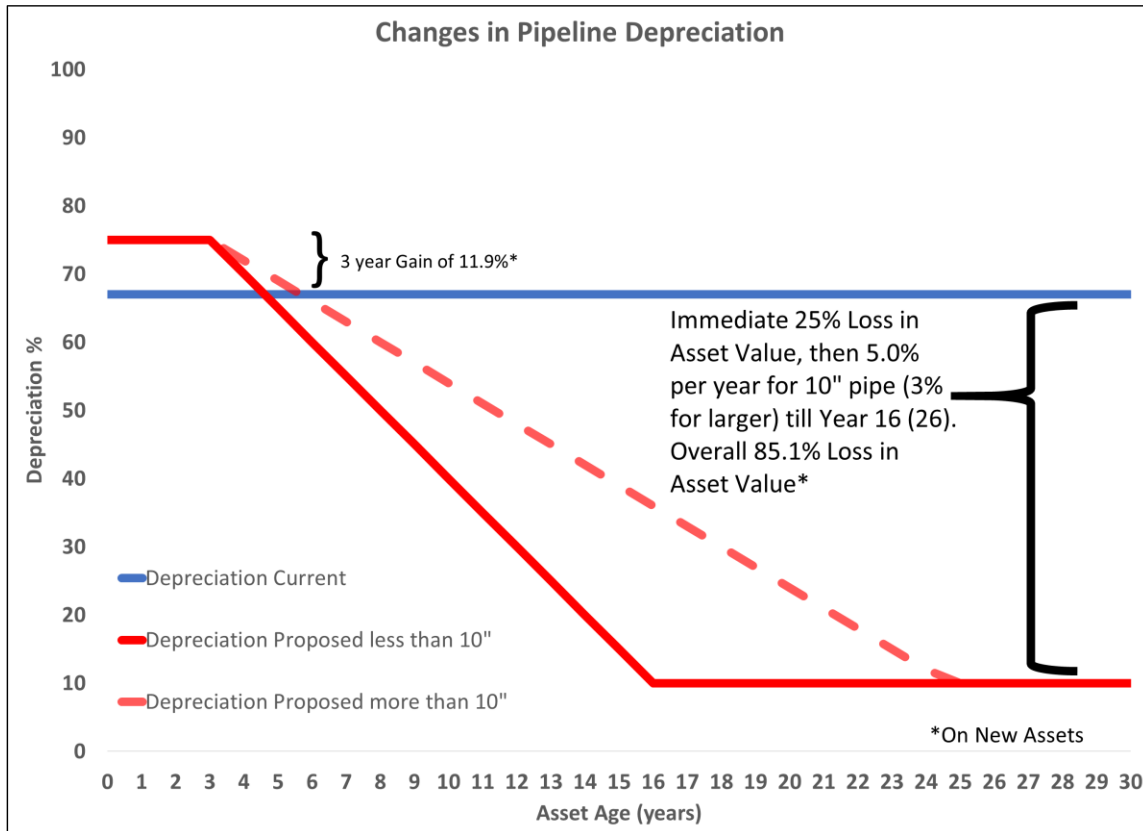
---

<sup>3</sup> Assumes a non-residential mill rate of 0.01311659 which is the average of RMA members.

# Linear Assessment of Pipelines

## Overview

Depreciation of pipeline assets would be treated similarly to wells, moving from a set factor of 0.67 to a straight-line depreciation model. Again, this would result in a brief (three-year) assessment increase compared to the status quo followed by a sharp decrease in value (the extent dependent on whether it is larger or smaller than 10-inch pipe) resulting in the 85.1% loss compared to current at 16 or 26 years of life.



## Change Summary

	Current Model	Scenario D
<b>Depreciation</b>	A set factor of 0.67 (67% asset value applied)	For all pipe sizes less than 10 inches, depreciation begins at 25% for the first four years and ends at 90%, dropping 5% per year until maximum depreciation (factor of 0.10) is reached in 16 years.  For sizes greater than 10 inches, depreciation begins at 25% for the first four years and ends at 90%, dropping 3% per year until maximum depreciation (factor of 0.10) is reached in 26 years.

<b>Additional Depreciation</b>	n/a	0.95 for CFB Suffield.
--------------------------------	-----	------------------------

***Example***

A company installs a new 8” pipeline that after costing, assessment year modifier (AYM) and any special depreciation (ministerial prerogative) had a remaining value of \$30,000.

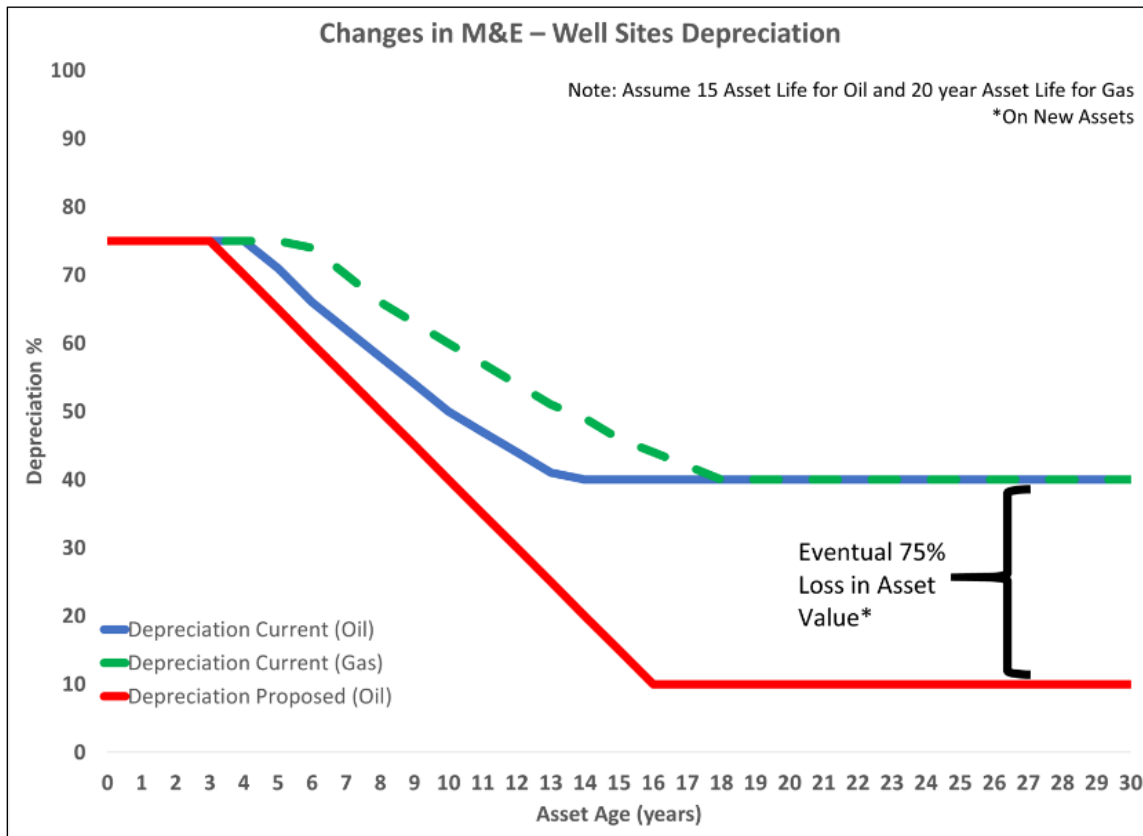
Under the current model, a standard 0.67 depreciation factor would be applied to the pipeline, allowing a municipality to apply their mill rate on \$20,100 of value. Under the new model, straight-line depreciation would be applied and the initial (three-year) factor of 0.75 would provide a modest improvement in valuation allowing the municipality to tax a value of \$22,500, an increase in tax revenue of 12.5% (\$295 instead of \$264) for the first three years of the pipeline’s life.

However, when the pipeline is 10 years old, the depreciation factor would be 0.40, reducing the taxable value to \$12,000, a drop in tax revenue of 40%. The corresponding calculation for a 16-year old pipeline would result in the use of 0.10 as a factor resulting in a taxable value of \$3000 and an 85% drop in tax revenue (\$264 to \$39) from the a 16-year old pipeline under the current model.

# Machinery & Equipment (M&E) on Well Sites

## Overview

M&E on well sites is currently assessed using a series of schedules based on the expected life of the asset from 10 years to 60 years. All tables provide an immediate 25% reduction in adjusted construction cost, then decrease over the estimated life of the asset (not actual production) until reaching 40% of adjusted value, where depreciation remains until the asset is decommissioned. The proposed changes would maintain 25% depreciation for the first four years of an asset’s life but would then drop dramatically over the next 12 years before reaching a floor of 10% of adjusted cost regardless of productivity or value.



## Change Summary

	Current Model	Proposed Scenario D
<b>Depreciation</b>	Depreciation schedules are set for assets based on their expected life from 10 years to 60 years. All eventually have a maximum depreciation of 40%.	Depreciation begins at 25% and ends at 90%, holding 25% for the first four years, and dropping 5% per year until maximum depreciation (factor of 0.10) is reached in 16 years.
<b>Additional Depreciation</b>	n/a	Loss in value from site-specific causes.
<b>Statutory Level or Adjustment Factor</b>		Legislated 77%.



For older assets, the changes may appear to result in a 30% drop in assessment value (from 40% to 10%). However, this actually would immediately remove 75% of the asset's assessed value (and associated tax revenue).

## Conclusion

This brief has focused on only the depreciation aspects of the Government of Alberta's proposed changes to the assessment model of regulated oil and gas properties. Depreciation was highlighted to provide insight into the likely long-term impacts of the adoption of any of the proposed scenarios. However, even with the limited information that has been shared, RMA is confident that the long-term impacts of the depreciation model changes alone will be very detrimental to members, regardless of which scenario is selected for implementation. RMA is also confident that due to the proposed changes to depreciation, the long-term impacts of the changes will impact nearly all rural municipalities even more substantially than the single-year snapshots that have been developed based on available data.

It must be stressed that the analysis above applies to only one of the four schedules attached to the Minister's Guidelines. Without access to actual municipal assessment data, RMA has no way to project the full impacts of these complex adjustments. This complexity and confusion not only reflects the lack of transparency of the current review process, but reinforces the rationale for RMA's opposition to the use of assessment valuation as a means to implement tax policy.