

<p>BOARD OF ASSESSMENT APPEALS, STATE OF COLORADO 1313 Sherman Street, Room 315 Denver, Colorado 80203</p> <hr/> <p>Petitioner:</p> <p>FRONTIER AIRLINES, INC.,</p> <p>v.</p> <p>Respondent:</p> <p>PROPERTY TAX ADMINISTRATOR.</p>	<p>Docket No.: 64842</p>
<p>ORDER</p>	

THIS MATTER was heard by the Board of Assessment Appeals on February 5, 2015, Diane M. DeVries and Gregg Near presiding. Petitioner was represented by Thomas E. Downey Jr., Esq. Respondent was represented by Robert H. Dodd Jr., Esq. Petitioner is protesting the 2014 actual value of the subject property.

Subject property is described as follows:

**Frontier Airlines, Inc.
7001 Tower Road
Denver, Colorado 80249
State Assessed Account Number: AL952**

The subject property consists of the operating property and plant of Frontier Airlines, Inc., a Colorado public utility.

As of February 3, 2015, the parties entered into a Stipulation of Facts and Issues relating to the appeal. The stipulation is included in the exhibits for both parties (Petitioner’s Exhibit 1 and Respondent’s Exhibit B). The Board considered this stipulation in reaching its decision for this appeal.

Petitioner presented the following indication of Colorado Actual Value (“CAV”):

Market: Not provided
Cost: Not provided

Income: \$102,686,489

Petitioner's witness, Kevin Thompson, CPA, CMI, of Complex PTS, testified regarding his experience with utility and non-utility clients and his recent history regarding the appeal with the Property Tax Administrator (PTA). During the process a number of modifications were applied to the 2013 income figures based upon correct classification of certain intangible assets and corrected equipment lists. The result of these efforts was an understanding regarding a final value of no greater than \$160,000,000.

In January of the 2014 tax year an adjusted Notice of Valuation was received indicating a value of \$141,488,569. Mr. Thompson testified regarding Colorado statutes and the appropriate "lookback period". Statute restricts the PTA to a period of not less than 2 years and not to exceed 5 years. Mr. Thompson referenced Petitioner's Exhibit 4 to illustrate the difference in CAV given Frontier's 5 year income history. Mr. Thompson stated a 5 year lookback provides a more just value.

Petitioner's witness, Robert F. Reilly, managing director for Willamette Management Associates, presented an income approach to derive a value of \$102,686,489 for the subject property.

Mr. Reilly described the cyclical nature of the airline industry citing the direct relationship between revenue and the cost of fuel. Unlike typical income properties where lease terms normally exceed 2 years, airlines are particularly vulnerable to the cost of fuel and that expense cannot easily be controlled. In 2009, the maximum lookback period, West Texas Intermediate Crude Oil prices declined 38% from the 2008 peak of \$99.67. Mr. Reilly pointed to the wide swings in annual net income for US air carriers compared to the more subdued variations if the income is considered on a 5 year average. Petitioner's witness testified the use of the 5 year lookback period results in a more reasonable estimate of sustainable income. For that reason the appropriate value is expressed by the 5 year weighted average expressed above of \$102,686,489.

Petitioner did not provide a market approach.

In rebuttal, Mr. Reilly presented a cost approach to derive a value of \$525,617,300 for the Frontier system. The net book value of the operating property on the value date, as provided by Petitioner, was \$1,452,827,918. Based on a 5 year weighted average return on the investment of 4.08% and a market capitalization rate of 11.29%, there is a loss of 63.82% on the expected return. This loss is applied to the net book value of the operating property as economic obsolescence. Mr. Reilly did not further allocate or adjust the system value to Colorado.

Petitioner is requesting a 2014 actual value of \$102,686,489 for the subject property.

Respondent presented the following indicators for Frontier's system value:

Market:	Not provided
Cost:	\$721,325,700
Income:	\$767,615,000

Respondent's witness, Curt Settle, State Assessed Manager for the Colorado Division of Property Taxation testified the State manages the assessment process for public utilities and then apportions the amounts to the respective counties. In this regard the first requirement is determination of the system value from which the value of the Colorado operations can be extracted.

Mr. Settle presented a cost approach to derive a system value of \$721,325,700 for the subject property. The net book value of the operating property on the value date, as provided by Petitioner, was \$1,452,827,918. Based on a 2 year weighted average return on the investment of 5.61% and a market capitalization rate of 11.29%, a loss of 50.35% results to the expected return. This loss is applied to the net book value of the operating property as economic obsolescence. After application of this adjustment, the system value, as determined by the cost approach, was \$721,325,700.

Mr. Settle presented an income approach to derive a system value of \$767,615,000 for the subject property by use of a weighted average of the last two years' income of \$86,663,733 and a market capitalization rate of 11.29%.

Mr. Settle gave equal weight to the system values determined by the cost and income approaches and concluded to a system market value of \$744,470,000. After allocations and adjustments to Colorado, the CAV was concluded to be \$141,448,569.

Respondent assigned an actual value of \$141,448,569 to the subject property for tax year 2014.

Petitioner contends the use of the last 2 years' income is not just or reasonable. The sides agree the airline industry is cyclical but Respondent has chosen to focus on only the good and ignores the bad. Petitioner points to an irregular pattern whereby Respondent has applied a 5 year lookback with at least three other carriers. Respondent's fixation upon Frontier's economic troubles at the beginning of the 5 year period is unreasonable due to the constant flux in this particular industry. Reorganization is a common practice allowing the airlines flexibility in dealing with union contracts.

Respondent's witness considered the 5 year lookback period as not representative of a full business cycle. Frontier Airlines also was a bankrupt company in 2009 and was just emerging from reorganization in 2011. The 2 year period captures the actual configuration of Frontier Airlines. Significant improvement in passenger numbers beginning in 2011 suggests the latest iteration of Frontier may be viable whereas the airline of 2009 was not.

The only approach to value that was fully developed by both parties was the income approach and the Board has chosen to focus on that arena. As agreed in the stipulation of both parties the "just value is not less than \$83,752,136 and not greater than \$142,956,971".

The parties clearly disagreed upon the correct time frame, the "lookback" period to be applied in determination of the imputed income. The Board was convinced that the airline industry is cyclical and shares the concerns of both parties regarding the fair time period to be applied given the restrictions of statute.

Testimony provided by Petitioner suggested the appropriate cycle for air transportation companies was between 6 to 10 years. Sources quoted within Petitioner's analysis state the income analysis should include one full business cycle of 5 to 10 years. Petitioner quotes the National Bureau of Economic Research where the 11 business cycles since 1945 to 2009 averaged 5.8 years for a full cycle then continues with further analysis of the airline industry by *Cyclical Dynamics of Airline Industry Earnings* concluding the appropriate cycle for the US airline industry is 10 years.

The Board was influenced by the information provided in Petitioner's Exhibit 3, Chart 2, page 11. In the 10 years of income presented, income considered on an annual basis shows wild swings in profitability; on a 2 year basis airlines are shown as profitable for 4 of 10 years ('06-'08 and '10-'12) and, when considered on a 5 year basis the airlines appear to have reached a breakeven point only once in 10 years. If profitability is a measure of airline success, the graph suggests the business cycle for this industry might well exceed 10 years.

Turning next to Chart 3 in the exhibit, Petitioner provides the income history for 4 airlines during the period 2000 to 2013. In this chart, for the 5 year allowed lookback period, 75% of the carriers were profitable for the entire period. The fourth airline was profitable 3 of the 5 years presented. Put another way, over the five years considered among the four airlines, only 2 years out of a total of 20 were not profitable.

Petitioner would have the Board consider Frontier's dismal balance sheet of 2011 to be a natural course of events, an expected setback in an industry that is constantly being reinvented and repositioned. The Board would consider the information in Chart 3 to suggest the opposite. The Board notes that two of the four airlines either remained flat or became more profitable in 2011. Frontier, on the other hand, reported a 135% decline in historical Net Operating Income ("NOI") during 2011.

The Board heard testimony that Frontier was a bankrupt operator in 2009 when purchased by Republic Airlines. In 2011, Republic chose to "spin off" their investment in a period of high fuel prices. Petitioner argues the decision to reposition, relocate and change Frontier's business model caused the loss but also states Frontier's operations remained "relatively similar during the period from 2009 to 2013". Given this circumstance, Petitioner considers the 5 year lookback period to be most appropriate.

Petitioner presented insufficient probative evidence and testimony to prove that the subject property was incorrectly valued for tax year 2014.

Based upon careful consideration of the arguments and exhibits presented, the Board finds insufficient support for Petitioner's contention that a 5 year lookback period is warranted. The Board heard testimony that the State has applied lookback periods longer than the 2 years used in this case and the State has been inconsistent in the historical application of this statute. Petitioner has failed to convince this Board that the 5 year period applied in this case represents a full business cycle. The Board has instead found a generally steady improvement among competing carriers during the period in question. The Board does not believe the facts support a reduction in the assessment. Rather, the Board finds the facts show that the operator chose to revamp the operation, change horses in mid-

stream, and take a large loss on the balance sheet. The Board was not convinced that this was business as usual.

Petitioner's witness, Mr. Reilly, stated in his own report:

"If the subject taxpayer was affected by a significant event during its last business cycle then it may not be appropriate to mix data from before the material event with data from after the material event."

The Board was persuaded by this statement and by Respondent's contention that the 2 year lookback period most clearly represented Frontier Airlines going forward.

As previously noted, Respondent testified a 5 year lookback period was not representative of a full business cycle. Frontier Airlines was a bankrupt company in 2009 and underwent a material change in operation by converting from a regional carrier to a low cost format. Losses caused by union contracts, plane sales and focus on a smaller operation were business decisions. Oil price increases magnified Frontier's losses but they were not the sole cause. The Board agrees with Respondent that the 2 year period best captures the actual configuration of Frontier Airlines.

The Board was also swayed by Respondent's inclusion of the cost approach in the analysis. Though both parties chose to focus upon the income approach, Respondent's inclusion of a complete cost approach led to greater confidence in the final value conclusion.

ORDER:

The petition is denied.

APPEAL:

Any Petitioner or any other public utility, assessor, or board of county commissioners adversely affected or the administrator may appeal any decision of the Board denying a petition in whole or in part to the Court of Appeals.

Any appeal may be taken to the Court of Appeals according to the Colorado appellate rules and the provisions of Section 24-4-106(11), C.R.S. (commenced by the filing of a notice of appeal with the Court of Appeals within forty-nine days after the date of the service of the final order entered), after the decision of the Board is issued.

Sections 39-4-109(1)-(2), C.R.S.

DATED and MAILED this 10th day of March, 2015.

BOARD OF ASSESSMENT APPEALS

Diane M DeVries

Diane M. DeVries

Gregg Near

Gregg Near

I hereby certify that this is a true
and correct copy of the decision of
the Board of Assessment Appeals.

Milla Liskchuk

Milla Liskchuk

