



GOVERNOR GREG GIANFORTE
DIRECTOR BRENDAN BEATTY

TO: Lara Ingrando, Director - Tax
AT&T

FROM: Doug Roehm, Unit Manager
Centrally Assessed Property

DATE: April 18, 2025

SUBJECT: Response to Comments on the 2025 Capitalization Rate Study,
Large Telecommunications

Dear Ms. Ingrando:

The department would like to thank you for taking the time to review our study and for providing additional information for us to consider. We received your submission email provided on April 4, 2025, along with a Cost of Capital Study prepared by Kroll, LLC for Communications (Large Cap).

The comments received along with these responses will be published on our website at:

<https://mtrevenue.gov/dor-publications/cap-rate-studies/>

Based on the comments and our analysis discussed below, we did change the capital structure used in calculating both the weighted average cost of capital (WACC) and both direct capitalization rates. Changing the capital structure resulted in a new WACC of 8.20%, a new NOI direct capitalization rate of 7.20%, and a new GCF direct capitalization rate of 14.20%.

No changes were made to the weighting of various approaches in selecting the cost of equity used to calculate the WACC.

A more detailed discussion on how we arrived at these conclusions follows.

Capital Structure

The following comments requesting a change to the capital structure were provided:

Charter appears to be an outlier compared to the other guideline companies. The average equity and debt percentage of the other three would be approximately 62% equity and 38% debt. This aligns with the attached study which a capital structure of 35% debt and 65% equity. We ask that this weighting be considered. (L. Ingrando, submission email, April 4, 2025)

Upon further review we did find support for moving our capital structure selection from 55% equity and 45% debt to 60% equity and 40% debt.

Our median and trimmed average calculated from all companies' capital structure as well as the Kroll study supported an increase in the cost of equity and a corresponding decrease in the cost of debt. Although Kroll selected a cost of equity of 65% and cost of debt of 35%, we were not persuaded to increase our weight on the cost of equity beyond 60%. Below is a chart developed from the various capital structure indicators provided in the Kroll study and Kroll's selected capital structure:

Description	% Equity	% Debt
Average	58.6%	41.4%
Median	58.5%	41.5%
2024 Estimate Utilized	60.0%	40.0%
5 Year Average	59.0%	41.0%
Using Est FV LTD (median)	60.0%	40.0%
Kroll Selected	65.0%	35.0%

(source: Kroll, Exhibit 3)

Cost of Equity

The following comments related to selection of the Cost of Equity were provided:

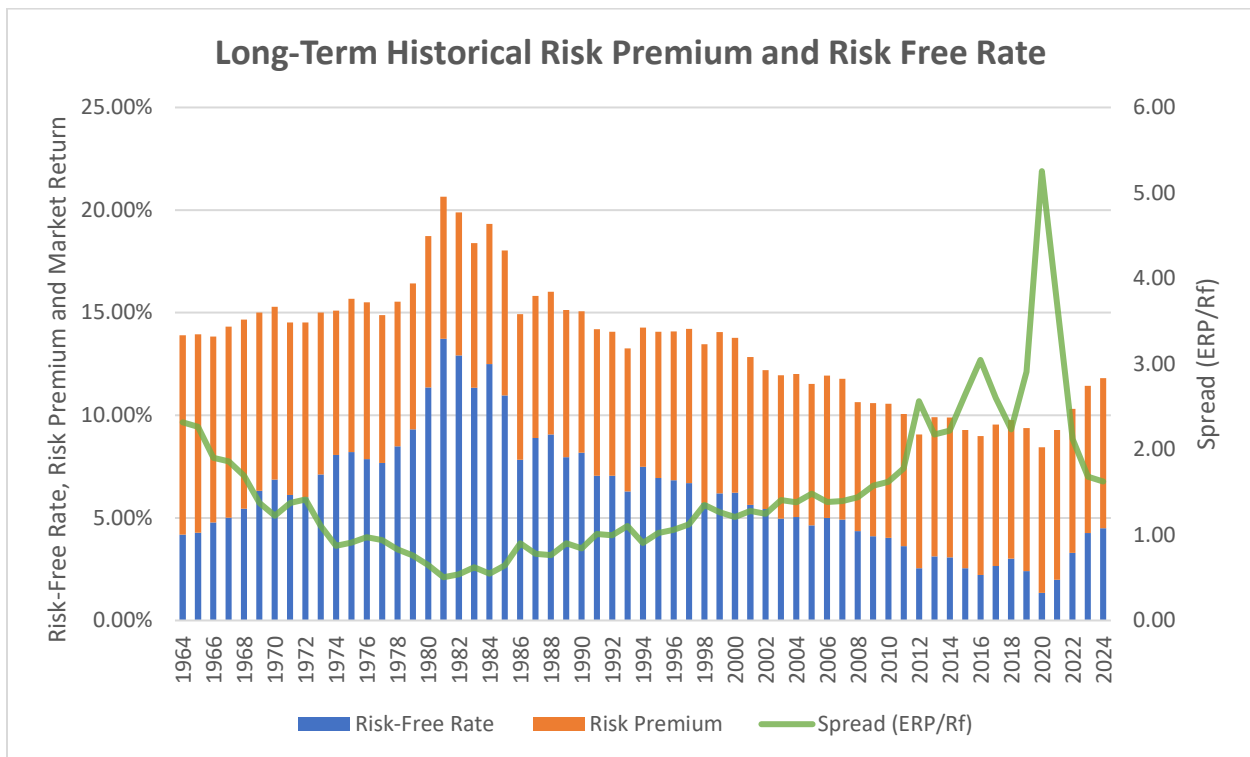
There are some discrepancies in this this (*sic*) area in which we appreciate any consideration. When viewed individually, the cost of equity estimated by the CAPM Ex Ante method (8.93%) and the 3 Stage Dividend Discount Model – Dividends (8.30%) appear low, especially relative to the estimated cost of debt of 5.99%. These models imply a spread between the cost of equity and cost of debt of 294 bps and 231 bps, respectively, which on the surface appears to be low.

Of the two Dividend Discount Models, the more appropriate model to use would be the model based on earnings growth as dividend policy can be changed depending on company needs: thus, impacting estimated dividend growth rates. A better indicator of growth is growth in earnings as such growth estimates from analysts' factor in more information into the forecasting process. It's worth mentioning that the current WSATA manual appears to be supportive of the position to the use of earnings growth rates.

Given the above, focusing in on the cost of equity estimates provided by the CAPM Ex Post method (11.44%) and the 3 Stage Dividend Discount Model – Earnings (11.85%) appear to provide better suited estimates for the cost of equity. The attached study performed by Kroll, which utilizes additional inputs and models, estimates a cost of equity of 11.50%, which would be supported by the DOR's methods. (L. Ingrando, submission email, April 4, 2025)

Spread Between Debt and Equity Rates

We agree that the cost of equity should be higher than the cost of debt as an equity investor has greater risk than a debt holder. However, the spread between debt and equity is not constant. Although not an exact comparison between equity and debt rates, one way to demonstrate this is to compare the equity risk premium to the risk-free rate over time. The chart below was developed from long-term historical risk premium and risk-free rate data to show how the spread between the equity risk premium and the risk-free rate varies over time. The spread is demonstrated by the green line and shows that the difference between the two is not constant and primarily changes along with the risk-free rate.



Additionally, the two indicated models only receive 32% of the weighting when reconciling to the selected cost of equity. The spread between the selected cost of equity (10.59%) and the selected cost of debt (5.99%) is 460 bp.

Estimate of sustainable growth rate in Dividend Discount Model

The WSATA Appraisal Handbook describes that in a dividend growth model the expected growth in dividends is theoretically the appropriate growth estimate to use. However, the manual does go on to explain that if earnings growth estimates differ dramatically from dividend growth estimates, earnings growth estimates may be preferred.¹ It is for similar reasons

¹ WSATA Appraisal Handbook (2009), Pg III-21

that the department calculates multiple cost of equity indicators and reconciles to a single cost of equity selection.

Although the two growth estimates are not identical, we continue to conclude that both growth estimates are deserving of similar weight in the reconciliation process. However, we do recognize that this is a consideration that will need to be reexamined each year in the reconciliation process.

Kroll Study

When considering the range of cost of equity estimates provided by Kroll in their Cost of Capital Study, no information is provided as to the weighting they applied to the various equity indicators when selecting 11.50%. The average of Kroll's indicators is 10.62% and the median is 10.48%. The departments conclusion of 10.59% is in line with the mid-point of Kroll's indicators. Without additional information regarding the weight placed on the various indicators by Kroll in selecting their cost of equity conclusion, we did not find support for changing our weighting on the various cost of equity conclusions in reconciliation.