April 14, 2016

Chad Gardner
Property Tax Manager
Hiland Crude, LLC
P.O. Box 4372
Houston, TX 77210-4372

RE: DOR response to comments and capitalization rate studies provided by the Liquid Pipeline Industry

Dear Mr. Gardner:

On behalf of the Montana Department of Revenue I would like to thank you and Bob for meeting with us to discuss our 2016 Capitalization Rate Study and for the information you provided for us to consider. After reviewing the information provided and additional industry information the department has made changes to our Capitalization Rate Study for the Liquid Pipeline industry. Three areas of our study were adjusted and are discussed in more detail below:

1. Yield Capitalization Rate
    a. It was suggested that our current cost of equity was not accurately reflecting the risk experienced by the industry and that more weight should be placed on the Dividend Growth Model. The Department believes the Capital Asset Pricing Model is a superior method for determining the current cost of equity. However, we did decide additional weight could be placed on the Dividend Growth Model with some adjustments made to the calculation. These adjustments are discussed in more detail as part of item number 2.
    b. With additional weight placed on the cost of equity estimates from the Dividend Growth Model the cost of equity was increased from 9.00% to 9.75% which increased the weighted average cost of capital from 7.20% to 7.70%

2. Dividend Growth Model
    a. The Model was first updated with the most current information available. Dividend yields, growth, etc.
    b. It was also determined that due to the fact the Department is discounting an after-tax cash flow a tax adjustment needed to be made to the comparable companies that do not pay federal income taxes. To accomplish this the expected dividend for each comparable that did not

pay federal income taxes was tax affected. With this adjustment made the Department felt the cost of equity conclusions from the Dividend Growth Model had more relevance and additional weight could be placed on them when selecting the cost of equity to be used in the weighted average cost of capital calculation.

   c. The formula used to make the adjustment was, D_1 x (1-t) where t = 38%

3. Capital Asset Pricing Model
   a. Historical, supply side, and conditional Equity Risk Premium (ERP) estimates were updated to the 2016 Valuation Handbook information based on what was provided in the Duff and Phelps cap rate study. This ultimately did not affect the ERP selected by the department and did not affect the cost of equity estimate from the Model.

The updated Capitalization Rate Study will be posted on the department's website for your review and can be found at https://revenue.mt.gov/home/publications.

The Department welcomes the opportunity to discuss these changes and any other issues in more detail during the appraisal process. If you have any further questions or concerns my contact information is below.

Thanks,

Doug Roehm

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