

[Senate Constitutional Amendment 9](#) (Glazer) @ 04/26/17

[Senate Bill 558](#) @ 04/26/17

Program: Property Taxes

Sponsor: Author

California Constitution Article XIII A, Section 2

Revenue and Taxation Code Section 74.8

Effective: If approved by voters, applies to construction completed on or after January 1, 2019.

Michele Pielsticker (Chief) 916.322.2376

Rose Marie Kinnee (Analyst) 916.445.6777

Chris Butler (Revenue) 916.445.0840

Summary: Subject to voter approval, excludes the installation of a rain water capture system from assessment as new construction.

Summary of Amendments: Since the previous analysis, the bill was amended to delay the operative date to improvements completed on or after January 1, 2019 and delete reference to specific rebate providers.

Purpose: According to the author, to promote the construction of more rain water capture systems through a tax incentive.

Fiscal Impact Summary: Unknown.

Existing Law: Under the California Constitution, all property is taxable unless specifically exempted, or authorized for exemption.¹ The Constitution limits the assessed value of property upon which the property tax is imposed. Generally, the law establishes a property's assessed value at its market value² on the date purchased (base year value) and requires additional assessments to reflect certain construction activities that qualify as "new construction."

New Construction. When substantial additions or alternations occur, the law requires the assessor to increase the assessment to reflect the value of "newly constructed" property.³ The assessor assigns the assessable new construction with its own distinct base year value. The remainder of the property's assessment is unaffected and retains its base year value.⁴

New Construction Exclusions. The Constitution allows the Legislature to provide that the term "newly constructed" does not include certain construction activities. These are commonly called "new construction exclusions." Any value added by these additions or alterations is not subject to the property tax.

Proposed Law: If voter-approved, the constitutional amendment would authorize the Legislature to exclude from the definition of "newly constructed" the construction or addition of a rain water capture system.

SB 558 contains the necessary implementing provisions by adding Revenue and Taxation Code (RTC) Section 74.8 to exclude the addition or construction of a rain water capture system from being considered "new construction" subject to property tax assessment. Additionally, it extends the exclusion's benefit to the first-purchaser of a new building built with a rain water capture system in limited circumstances. This allows the first buyer to receive the exclusion's benefit which would otherwise terminate due to the property's sale (change in ownership).

¹ Article XIII Section 1 of the California Constitution.

² The assessed value is based on 1975 market value for property that has not changed ownership since that date.

³ Article XIII A Section 2 of the California Constitution (Proposition 13) and Revenue and Taxation Code Section 70. Additionally, "supplement assessment" laws make the new construction taxable as of the completion date.

⁴ Unless the new construction replaces certain types of existing improvements, in which case the value attributable to those preexisting improvements is deducted from the property's existing base year value.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

In General: California’s Property Tax System. Voters changed California’s property tax system through Proposition 13, which replaced a current market value-based system with an acquisition value-based system. Under Proposition 13, real property assessed values were set at 1975 market value levels and future assessed value increases were limited to the inflation rate, not to exceed 2%, for as long as the property’s ownership remains unchanged and the property is not substantively improved (i.e., new construction). Proposition 13 also limited the basic property tax rate to 1% plus voter- approved bonded indebtedness. The current system provides certainty to property owners regarding future property tax liability. The 2% maximum inflation adjustment ensures modest assessed value increases, assuming no ownership changes or substantive property improvements.

New Construction. The California Constitution does not define the terms “new construction” or “newly constructed.” RTC Section 70 defines these terms to mean:

- Any addition to real property, whether land or improvements (including fixtures), since the last lien date.
- Any alteration of land or any improvements (including fixtures) since the last lien date that constitutes a “major rehabilitation⁵” or that converts the property to a different use.

The BOE Assessors’ Handbook Section 410, [Assessment of Newly Constructed Property](#) provides detailed information.

Constitutional amendments. Since Proposition 13, voters have approved numerous constitutional amendments to allow new construction exclusions and have rejected two, as detailed in the following tables.

Prop	Election	Property Improvements	RTC
8	November 1978	Disaster Reconstruction	§70(c)
7	November 1980	Solar Energy Systems	§73
31	November 1984	Fire Safety Systems and Fire Egress	§74
110	June 1990	Disabled Access Related Improvements (Residential)	§74.3
177	June 1994	Disabled Access Related Improvements (All Properties)	§74.6
1	November 1998	Environmental Contamination Reconstruction	§74.7
13	June 2010	Seismic Safety Retrofitting & Hazard Mitigation <i>Changes Proposition 23 and 127 and lifted 15 year limit</i>	§74.5
127	November 1990	Seismic Safety Retrofitting & Hazard Mitigation	§74.5
23	June 1984	Seismic Safety (Unreinforced Masonry – first 15 years)	§70(d) (Former)

Measures rejected include:

Prop	Election	Property Improvements	RTC
34	November 1984	Historical Reconstructions (Homes)	N/A
178	June 1994	Water Efficiency Improvements	N/A

The RTC provides a new construction exclusion⁶ related to underground storage tank upgrades made to comply with government standards. Unlike the others, this exclusion was not expressly authorized via a constitutional amendment and was categorized as normal maintenance and repair not assessable as new construction.

⁵ A major rehabilitation is any rehabilitation, renovation, or modernization that converts an improvement or fixture to the substantial equivalent of a new improvement or fixture.

⁶ RTC Section 70(d)

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Exclusion v. Exemption. These provisions are not a real property tax “exemption” but a new construction “exclusion.” The exclusion/exemption distinction is important for several reasons:

- Exclusions terminate if a transfer of the property results in a property’s change in ownership (a reappraisal event).
- Exclusions only extend to the rain water capture system itself.
- Exclusions have limited applicability if the property is not assessed under Proposition 13’s base year value standard. Examples of property subject to other preferential assessment standards include: Williamson Act, Farmland Security Zones, and Mills Act historical properties.
- Exclusions are inapplicable to state-assessed property.

Commentary:

1. **Effect of the bill.** If voters approve the constitutional amendment, the installation of a rain water capture system completed on or after January 1, 2019 will have no property tax consequence.
2. **April 26, 2017** amendments change the operative date to new construction completed on or after January 1, 2018 to January 1, 2019 in both measures. In the implementing statutory measure, the amendments delete references to specific rebate providers. As noted in the prior analysis, the listed providers were applicable to the solar exclusion.
3. **Rationale.** The author states that the goal of this property tax exclusion is to promote a significant expansion of rain water collection systems throughout the state. If more Californians store water, then the systems would reduce the effect of persistent droughts. Additionally, the author notes these systems benefit everyone, as they free up conventionally sourced water for others to use.
4. **A wide range of rain water capture systems are possible.** A system could include a [single rain barrel](#) connected to a gutter, a newly built property with special design features, a system with above or [below ground](#) cisterns, a computerized system with outdoor ponds used across a [college campus](#), or a computerized system in a manufacturing facility for [indoor plumbing](#).
5. **"Rain water capture system" undefined.** The SCA states that the Legislature will define a “rain water capture system. However, the implementing statute lacks any definition. Definitions help agencies efficiently administer the exclusion. For example, they help denote what a “system” includes, how to treat a dual rainwater/graywater system, how to handle other dual use parts in the system, or how to treat a system that is part of a larger scale remodel, whether in a home or a large commercial/industrial property.

For purposes of the [Rainwater Capture Act of 2012](#), Water Code Section 10573(d) provides that “rainwater capture system” means a facility designed to capture, retain, and store rainwater flowing off a building rooftop for subsequent onsite use.

The Los Angeles County Department of Public Health is one of the first agencies to develop detailed [guidelines](#) addressing alternative water sources: rainwater, graywater, stormwater and recycled water. The guidelines summarize rainwater system requirements for (1) outdoor or indoor use and (2) pressurized or non-pressurized systems. The guidelines provide insight into practical administrative questions that will arise in implementing the exclusion.

6. **The author should consider addressing the built-for-sale “first purchaser” provision in the constitutional amendment.** The implementing statute is modeled after the solar new construction exclusion implementing statute. The built-for-sale provisions in the solar exclusion were added decades after the initial solar-related constitutional amendment. The comparable “initial-purchaser limitation provision”⁷ [RTC Section 74.8(a)(2)] is complex and difficult to administer. The limitation only exists to cure the constitutional constraint that new construction exclusions end after a change in ownership. In this case, the SCA can be designed to include the built-for-sale scenario from the start. This precludes the need for a limitation that can bar the building’s first buyer from the exclusion’s benefit.

⁷ It relates to the supplemental assessment builder's exclusion, and is keyed to the timing of certain events.

7. **Administrative provisions limited to the built-for-sale scenario.** The implementing statute's detailed administrative provisions relate solely to the first purchaser of a new building.

Costs: The BOE would incur costs to update publications and the website, and address ongoing implementation issues.

Revenue Impact: Background Methodology, and Assumptions. Staff research indicates that costs associated with rain water capture systems can vary widely. Some basic residential systems may cost a few hundred dollars while more sophisticated, commercial systems can cost in the tens or hundreds of thousands of dollars or more. Estimating the revenue impact of this bill is difficult because we do not know the average cost of a rain water capture system in California. As for point of reference, we do not know the number of existing systems currently in use nor how many resulted in a property tax increase as assessable new construction. Some systems may have been considered insignificant improvements, while others may have been installed or constructed on tax exempt properties, such as government-owned property or welfare exemption-eligible properties. Further, we do not know the number of newly built buildings for sale that include a rainwater capture system.

We can provide an order of magnitude measured at the basic 1% property tax rate. Assuming cost equates to market value, every \$1 million in cost of rain water capture systems equates to \$10,000 in local revenue loss.

Revenue Summary: The revenue impact is unknown. Assuming cost equates to market value, every \$1 million in cost of a rain water capture system equates to \$10,000 in local revenue loss.

Qualifying Remarks: While the revenue impact is unknown, a greater impact will result if: (1) state or local mandates require newly constructed property to include rain capture water systems; (2) other federal, state, or local incentives to encourage property owners to add the systems to existing property are offered; or (3) the systems become economically beneficial to property owners.