



[SB 1164](#) (Newman)

Amended: April 11, 2024

Program: Property Taxes

Revenue and Taxation Code Section 74.9

Effective: Immediately/Upon Signature

Ted Angelo (Division Chief) 916-274-3423

Ronil Dwarka (Analyst) 916-274-3391

Ronil Dwarka (Revenue) 916-274-3391

Analysis Date: May 14, 2024

Summary: This bill would exclude from assessment the construction of an accessory dwelling unit (ADU) until 15 years have passed since construction of the ADU was completed or there is a subsequent change in ownership of the ADU.

Fiscal Impact Summary: Estimated annual property tax revenue loss of \$19 million.

Summary of Amendments:

The April 11, 2024, amendments state and clarify that, in order to receive the exclusion, the property owner shall do all of the following:

- Maintain the residential use of the accessory dwelling unit receiving the exclusion.
- Provide any additional documentation that the Assessor requests and ensure all additional documents necessary to support the exclusion are filed with the Assessor no later than six months after the completion of the project.
- Inform the Assessor within 30 days if the ADU is converted to any use other than for residential housing.

The amendments also clarify the following:

- That the exclusion provided under Section 74.9 shall remain in effect until 15 years have passed from the first lien date following completion of construction on the ADU, unless the unit undergoes a change in ownership or is converted to any use other than for residential housing.
- That construction of an ADU must be completed on or after January 1, 2025, and before January 1, 2030, in order to qualify for the exclusion.
- That, upon the occurrence of one the events related to the ADU losing its exclusion status, the new base year value of the unit shall be established as of the occurrence of the event, adjusted annually in accordance with paragraph (1) of subdivision (a) of Section 51, and be enrolled.
- That the proposed changes to RTC 74.9 sunset on January 1, 2046.

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.

Existing Law: California's system of property taxation values property at its 1975 fair market value, with annual increases limited to the inflation rate, as measured by the California Consumer Price Index, or 2 percent, whichever is less, until the property changes ownership or is newly constructed.¹ At the time of the ownership change or completion of new construction, the real property, for property tax purposes, is reassessed to current market value (called the "base year value").² Thereafter, the base year value is subject to annual increases for inflation. This value is referred to as the "factored base year value."³

New Construction. When additions or substantial alterations occur, the law requires a County Assessor to increase the property's assessment to reflect the value of the "newly constructed" property.⁴ The Assessor then 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.⁵

Under [Property Tax Rule 463.500](#), the date of completion of new construction resulting from actual physical new construction on a site is the earliest of either the date upon which the new construction is available for use by the owner or the date the property is occupied or used by the owner or with the owner's consent.

New Construction Exclusions. The California 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 property tax.

Proposed Law: This bill would add section 74.9 to the Revenue and Taxation Code (RTC) to exclude from classification as "newly constructed" and "new construction" the construction of an accessory dwelling unit (ADU), as defined until 15 years have passed since construction on the accessory dwelling unit was completed or there is a subsequent change in ownership of the accessory dwelling unit. The bill would require the property owner to, prior to or within 30 days of completion of the project, notify the County Assessor that the property owner intends to claim the exclusion for an ADU and submit an affidavit stating that the owner shall make a good faith effort to ensure the ADU will be used as residential housing for the duration the owner receives the exclusion. The bill would require the State Board of Equalization (BOE) to prescribe the manner and form for claiming the exclusion and would require all additional documents necessary to support the exclusion to be filed by the property owner with the Assessor not later than 6 months after the completion of the project.

For purposes of section 74.9, "accessory dwelling unit" means an attached or detached residential dwelling unit that provides complete, independent living facilities for one or more persons and that is located on a lot with a preexisting, single-family or multi-family residential dwelling on the lot. An "accessory dwelling unit" shall include permanent provisions for living, sleeping, eating, cooking, and sanitation on the same parcel that the single-family or multifamily residential dwelling is located.

¹ Article XIII A, section [2](#), of the California Constitution (Proposition 13).

² Revenue and Taxation Code (RTC) sections [110](#) and [110.1](#).

³ Article XIII A, section [2](#), of the California Constitution.

⁴ Rev. & Tax. Code, section [70](#).

⁵ Rev. & Tax. Code, section [71](#).

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.

An “accessory dwelling unit” includes, but is not limited to, any of the following:

- An efficiency unit, as defined in section 17958.1 of the Health and Safety Code.
- A manufactured home, as defined in section 18007 of the Health and Safety Code.

In General: California's Property Tax System. In June 1978, voters changed California's property tax system through Proposition 13, which replaced a then-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 percent, for as long as the property's ownership remains unchanged and the property is not substantively improved (i.e., new construction). The 2 percent 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 rehabilitation" or that converts the property to a different use.

RTC section 71 requires an Assessor to determine a new base year value for the portion of real property that has been newly constructed and provides that the base year value of the remainder of the property assessed, which did not undergo new construction, does not change.

Background: Existing law authorizes a local agency to provide by ordinance for the creation of an ADU in single-family and multifamily residential zones and requires that an ADU comply with certain conditions.⁶ An ADU is defined as an attached or detached residential dwelling unit that provides complete independent living facilities for one or more persons and includes permanent provisions for living, sleeping, eating, cooking, and sanitation on the same parcel as a single-family dwelling is situated.⁷ An ADU also includes an efficiency unit⁸ and a manufactured home.⁹

Previous Legislation: In 2002, Assembly Bill (AB) 1866 (Stats.2002, Ch. 1062) required local governments to use a ministerial process for approving ADUs, notwithstanding other laws that regulate the issuance of variances or special use permits. A local government may provide for the construction of ADUs by ordinance, and may designate areas where ADUs are allowed, as well as require standards for parking, setback, lot coverage, and maximum size. If a local government has not adopted an ordinance governing ADUs, it must grant a variance or special use permit for the creation of ADUs if the unit complies with requirements specified in statute, including size and zoning restrictions.

⁶ Gov. Code, sections [65852.150](#), [65852.2](#), and [65852.22](#).

⁷ Gov. Code, section 65852.2(h)(4).

⁸ Health & Saf. Code section, [17958.1](#).

⁹ Health & Saf. Code, section [18007](#).

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 2016, the California Legislature passed two bills AB 2299, (Stats. 2016 Ch. 735), and SB 1069, (Stats. 2016 Ch. 720), that required cities and counties to allow ADUs on most residential lots, preempting local zoning ordinances and other permitting processes. In 2023, AB 1033 (Stats. 2023, Ch. 752) authorized a local agency to adopt a local ordinance to allow the separate conveyance of the primary dwelling unit and accessory dwelling unit or units as condominiums.

Prior 15-Year New Construction Exclusion for Unreinforced Masonry Buildings.

Proposition 23 was approved by California voters in 1984 and provided a 15-year new construction exclusion for improvements to unreinforced masonry buildings undertaken to comply with local ordinances on seismic safety. This new construction exclusion was implemented by RTC section 70(d). Former RTC section 70(d) specified that the exclusion was to remain in effect during the first 15 years following that reconstruction or improvement unless the property was purchased or changed ownership during that period. Former RTC section 70(d) also specifically provided that in the sixteenth year following the reconstruction or improvement of the unreinforced masonry building, the Assessor was to place on the roll the current full cash value of the portion of reconstruction or improvement to the structure that was excluded. In 2010, this 15-year exclusion was eliminated, and its seismic safety improvements were incorporated into the seismic safety retrofitting new construction exclusion that was approved by voters in 2008 and implemented by RTC section 74.5.

Commentary:

1. **Valuation of New Construction, the Exclusion Amount.** When assessable new construction is added to real property, a County Assessor is required to assess the new construction at fair market value. The Assessor may determine the market value of the ADU based on one or more of the following indicators, depending on the availability of data: a sales comparison evaluation of similar homes in the area with ADUs and properties without or sales of ADUs, by determining the cost to build or replace the ADU, or by evaluating the ADU's income potential.
2. **Value to Enroll at End of 15-Year Period.** RTC section 75.10 requires a County Assessor to appraise any new construction at its full cash value on the date the new construction is completed. However, under former section 70(d), the prior 15-year new construction exclusion for unreinforced masonry buildings specifically provided that the value to enroll at the end of the 15-year exclusion period was the current market value. It would be helpful for this new exclusion to specifically state what value the Assessor is to enroll at the end of the 15-year exclusion period.

The April 11 amendments clarify that a new base year value will come into effect upon the occurrence of any one of the following: 1) the passage of 15 years following the ADU construction completion date, 2) a change in ownership of the ADU, or 3) a conversion of the ADU to nonresidential use.

3. **Base Year Value of an Existing Structure and Land.** Existing law specifies that only the newly constructed portion of property is assessed and that the base year value of the

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.

remainder of the property, which did not undergo new construction, does not change. Thus, this bill is consistent with existing RTC section 70 and 71 requirements.

4. **Construction in Progress.** Under RTC section 71, new construction in progress on the lien date must be appraised at its full value on the lien date and each lien date thereafter until the date of completion. Will construction in progress of an ADU also be eligible for this new construction exclusion? If so, how will a County Assessor identify whether a permit is for an ADU, as not all local permit-issuing agencies are consistent.
5. **Filing Period.** This bill requires a property owner to notify the Assessor prior to or within 30 days of completion of the project that the property owner intends to claim the exclusion for an ADU. The 30-day requirement is a very short time. With other new construction exclusions, the notification is done via filing the claim for exclusion. Property owners may not know to notify the Assessor within 30 days of completion of the project. If the issue is to ensure an Assessor is aware of the intent to file an exclusion within 12 months of the date of commencement of construction, perhaps another notification timeframe would be preferable so Assessors know early on that its headed for an exclusion.

The April 11 amendments now require the property owner to provide any additional documentation that the Assessor requests, and to file all additional documents necessary to support the exclusion with the Assessor no later than six months after the completion of the project.

Costs: The BOE would incur costs of approximately \$10,237 for fiscal year (FY) 2024-25, \$64,782 for FY 2025-26 and \$729 for the two years thereafter.

Revenue Impact: According to the *University of California Berkeley Center for Community Innovation (CCI)*, 28,547 ADUs were permitted in California in 2022. Actual ADUs built in 2022 totaled 13,439. In a 2021 paper by CCI entitled [Implementing the Backyard Revolution: Perspectives of California's ADU Owners](#), the median statewide construction cost of an ADU was estimated to be \$150,000.

Assuming the above numbers reflect the current ADU climate in California, the total annual construction cost is estimated to be about \$2 billion ($\$150,000 \times 13,439$). Based on the 1% property tax rate, annual property tax revenue loss is estimated to be about \$20 million ($1\% \times \2 billion).

The recent homeowner turnover rate in California suggests a rate of 7%. Adjusting for annual turnover, we estimate an annual property tax revenue loss of \$19 million.

Qualifying Remark:

The above analysis provides a revenue impact based on ADUs built annually and the homeowner turnover rate. It does not factor in the 15-year mark when the exclusion ends for an ADU. The revenue impact is based on 2021 and 2022 data. According to the California Department of Housing and Community Development, 2023 ADU permit data will not be available until mid-June 2024.

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.