

SANTA CLARA COUNTY ASSESSMENT PRACTICES SURVEY

DECEMBER 2003

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December 19, 2003

TO COUNTY ASSESSORS:

SANTA CLARA COUNTY
ASSESSMENT PRACTICES SURVEY

No. 2003/086

A copy of the Santa Clara County Assessment Practices Survey Report is enclosed for your information. The Board of Equalization (BOE) completed this survey in fulfillment of the provisions of sections 15640-15646 of the Government Code. These code sections provide that the BOE shall make surveys in each county and city and county to determine that the practices and procedures used by the county assessor in the valuation of properties are in conformity with all provisions of law.

The Honorable Lawrence E. Stone, Santa Clara County Assessor, was provided a draft of this report and given an opportunity to file a written response to the findings and recommendations contained therein. The report, including the assessor's response, constitutes the final survey report which is distributed to the Governor, the Attorney General, and the State Legislature; and to the Santa Clara County Board of Supervisors, Grand Jury, and Assessment Appeals Board.

Fieldwork for this survey was performed by the BOE's County Property Tax Division from March through August 2002. The report does not reflect changes implemented by the assessor after the fieldwork was completed.

Mr. Stone and his staff gave their complete cooperation during the survey. We gratefully acknowledge their patience and courtesy during the interruption of their normal work routine.

These survey reports give government officials in California charged with property tax administration the opportunity to exchange ideas for the mutual benefit of all participants and stakeholders. We encourage you to share with us your questions, comments, and suggestions for improvement.

Sincerely,

/s/ David J. Gau

David J. Gau
Deputy Director
Property and Special Taxes Department

DJG:jm
Enclosure

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INTRODUCTION

Although county government has the primary responsibility for local property tax assessment, the State has both a public policy interest and a financial interest in promoting fair and equitable assessments throughout California. The public policy interest arises from the impact of property taxes on taxpayers and the inherently subjective nature of the assessment process. The financial interest comes from the fact that more than one-half of all property tax revenue is used to fund public schools and the State is required to backfill any shortfalls from that property tax funding.

The assessment practices survey program is one of the State's major efforts to address these interests and to promote uniformity, fairness, equity, and integrity in the property tax assessment process. Under this program, the State Board of Equalization (BOE) periodically reviews the practices and procedures of (surveys) every county assessor's office. This report reflects the BOE's findings in its current survey of the Santa Clara County Assessor's Office.

Readers of previous assessment practices survey reports will note several distinct changes in the format of the report. Among other things, the previous reports commonly contained multi-part recommendations and formal suggestions. Each recommended change is now listed as a separate recommendation. Items that would have been formal suggestions under the previous format are now either recommendations or are stated informally within the text of the report. Both of these changes increase the number of recommendations in the survey reports.

The assessor is required to file with the board of supervisors a response that states the manner in which the assessor has implemented, intends to implement, or the reasons for not implementing the recommendations contained in this report. Copies of the response are to be sent to the Governor, the Attorney General, the BOE, the Senate and Assembly, the Santa Clara County Grand Jury, and the Assessment Appeals Board. That response is to be filed within one year of the date the report is issued and annually thereafter until all issues are resolved. The Honorable Lawrence E. Stone, Santa Clara County Assessor, elected to file his initial response prior to the publication of our survey; it is included in this report following the Appendices.

While typical management audit reports emphasize problem areas, they say little about operations that are performed correctly. Assessment practices survey reports also tend to emphasize problem areas, but they also contain information required by law (see *Scope of Assessment Practices Surveys*) and information that may be useful to other assessors. The latter information is provided in the hope that the report will promote uniform, effective, and efficient assessment practices throughout California.

SCOPE OF ASSESSMENT PRACTICES SURVEYS

Government Code sections 15640 and 15642 define the scope of an assessment practices survey. As directed by those statutes, our survey addresses the adequacy of the procedures and practices employed by the assessor in the valuation of property, the volume of assessing work as measured by property type, and the performance of other duties enjoined upon the assessor.

In addition, pursuant to Revenue and Taxation Code¹ section 75.60, the BOE determines through the survey program whether the county assessment roll meets a minimum assessment level for purposes of certifying the eligibility of the county to continue to recover costs associated with administering supplemental assessments. This certification may be accomplished either by conducting an assessment sample or by determining, through objective standards—defined by regulation—that there are no significant assessment problems. The statutory and regulatory requirements pertaining to the assessment practices survey program are detailed in Appendix C.

Our survey of the Santa Clara County Assessor's Office included reviews of the assessor's records, interviews with the assessor and his staff, and contact with other public agencies in Santa Clara County that provided information relevant to the property tax assessment program. This survey also included an assessment sample of the 2001-02 assessment roll to determine the average level (ratio) of assessment for all properties and the disparity among assessments within the sample. The ideal assessment ratio is 100 percent, and the minimum acceptable ratio is 95 percent. Disparity among assessments is measured by the sum of absolute differences found in the sample; the ideal sum of absolute differences is 0 percent and the maximum acceptable number is 7.5 percent. If the assessment roll meets the minimum standards for ratio and disparity, the county is eligible to continue to recover the administrative cost of processing supplemental assessments. The sampling program is described in detail in Appendix B.

This survey report offers recommendations to help the assessor resolve the problems we have identified. The recommendations contained in this report are based on the results of our research into statutory violations, under- or overassessments, or unacceptable appraisal practices that may occur in specific areas.

An assessment practices survey is not an audit of the assessor's entire operation. We do not examine internal fiscal controls or the internal management of an assessor's office outside those areas related to assessment.

¹ Unless otherwise stated, all statutory references are to the California Revenue and Taxation Code.

EXECUTIVE SUMMARY

As stated in the Introduction, this report emphasizes problem areas in the operations of the assessor's office. However, it also identifies program elements that are particularly effective and describes areas of improvement since the last assessment practices survey.

In the 1998 Santa Clara County Assessment Practices Survey, 10 recommendations were made to address problems in the assessor's assessment policies and procedures. The assessor fully implemented five of the recommended changes, partially implemented two, and did not implement three. The statements below summarize the findings of the current survey:

- The assessor is proactive in the discovery and valuation of properties that have experienced a decline in value.
- The assessor completed the 2001-02 assessment roll on time and under budget.
- In the past year, the assessor resolved a record number of business personal property assessment appeals.
- The assessor has automated business personal property exemption procedures to further streamline exemption claims processing.
- For 2002-03, the assessor implemented e-filing of business property statements. This will allow approximately 30,000 small businesses to file their annual reports electronically. The assessor has improved the valuation of water companies so that it is consistent with BOE's recommendations.
- The assessor has added new and enhanced computer applications in the business property division; these enhancements have streamlined the processing of business property statements.
- Some types of business properties are valued and enrolled by non-certified staff members without subsequent review by a certified auditor-appraiser.
- The assessor should obtain fire reports to aid in the discovery of property damaged by misfortune or calamity; moreover, he should recognize restricted access as a condition qualifying for disaster relief.
- The assessor improperly applies the county's low-value property exemption to certain aircraft and possessory interests.
- The assessor uses incorrect versions of BOE-prescribed forms, and fails to timely return the annual forms checklists and final printed forms to the BOE.
- The assessor does not correctly identify escape assessments on his current assessment roll.

- The assessor's two-year list of transfers does not conform to the requirements of section 408.1. The list is not divided into geographical areas and it lacks specific data required by the Revenue and Taxation Code. The list also displays confidential information.
- The assessor should depreciate new additions to older structures when assessing new construction.
- The assessor over-assesses agricultural land by failing to deduct a capital replacement charge for irrigation wells, fails to document base year values for all CLCA parcels, and improperly calculates income charges for nonliving improvements on CLCA land.
- The assessor does not enroll the lower of the current market value or the restricted value as the base value for taxable government-owned land.
- The assessor inappropriately reappraises month-to-month possessory interests before the end of the anticipated term of possession.
- The assessor improperly classifies and assesses leasehold improvements, and fails to consistently investigate leasehold improvements reported on business property statements.
- The assessor's mandatory audit program is well administered and effective.
- The assessor should review business property statement filings more carefully, and should reject incomplete statements filed by leasing companies.
- The assessor should remove from his direct billing program accounts of \$100,000 and larger, since taxpayers with such accounts are required to file annual property statements.
- The assessor assesses biopharmaceutical property in an inconsistent manner.
- The assessor should revise his method of estimating the value of an assessee's property when a business uses both real property and personal property and the assessee fails to file a business property statement.
- The assessor should have a sound basis for his valuation schedules and depreciation adjustments for apartment personal property and vessels.
- The assessor continues to use "minimum" valuation factors that overstate the value of some business property.
- The assessor should revise his method of performing annual reviews of the values of manufactured homes located in rental parks, correctly apply the inflation factor to the assessments of manufactured homes that transfer between January 1 and June 30, and enroll manufactured homes as personal property.
- The assessor should consistently assess taxable animals, including racehorses, according to statutory and regulatory requirements.

The Santa Clara County assessment roll meets the requirements for assessment quality established by section 75.60. Our sample of the 2001-02 assessment roll indicated an average assessment ratio of 99.25 percent, and the sum of the absolute differences from the required assessment level was 1.96 percent. Accordingly, the BOE certifies that Santa Clara County is eligible to continue receiving reimbursement of costs associated with administering supplemental assessments.

Here is a list of the formal recommendations contained in this report, arrayed in the order that they appear in the text.

RECOMMENDATION 1:	Use certified appraisers to value aircraft and vessels.....	14
RECOMMENDATION 2:	Obtain fire reports from local fire departments to discover property damaged or destroyed by a misfortune or calamity.....	19
RECOMMENDATION 3:	Grant disaster relief for all qualifying misfortunes or calamities, as provided in rule 139.....	19
RECOMMENDATION 4:	Properly apply the low-value property exemption.	20
RECOMMENDATION 5:	Use the correct version of BOE-prescribed forms.	20
RECOMMENDATION 6:	Timely return all forms checklists to the BOE.....	21
RECOMMENDATION 7:	Submit final prints of all forms as required by rule 171(a).....	21
RECOMMENDATION 8:	Correctly identify penalty and escape assessments on the current assessment roll, as required by section 533 and rule 261.....	22
RECOMMENDATION 9:	Include only that information on the list of transfers that is required by section 408.1.	27
RECOMMENDATION 10:	Apply an appropriate depreciation allowance to the value of newly constructed additions to existing improvements.	30
RECOMMENDATION 11:	Deduct a capital replacement allowance for irrigation wells that contribute to the income being capitalized.....	33
RECOMMENDATION 12:	Establish base year values for CLCA property.	34
RECOMMENDATION 13:	Properly calculate the income charge to nonliving improvements.....	34
RECOMMENDATION 14:	Enroll the lesser of current market value or restricted value as the base year value of taxable government-owned land.	35

RECOMMENDATION 15: Reappraise month-to-month possessory interests only at the expiration of the anticipated term of possession as provided in section 61(b)(2).36

RECOMMENDATION 16: Correctly classify and assess leasehold improvements.....38

RECOMMENDATION 17: Investigate all reported leasehold improvement costs.....39

RECOMMENDATION 18: Ensure that all equipment is properly assessed upon termination of lease.44

RECOMMENDATION 19: Include only accounts with a cost of less than \$100,000 in the direct billing program.45

RECOMMENDATION 20: Properly classify and consistently assess biopharmaceutical industry equipment.....45

RECOMMENDATION 21: Make estimated assessments based upon available information, as required by section 501.....46

RECOMMENDATION 22: Properly assess personal property in apartments.....47

RECOMMENDATION 23: Use Assessors' Handbook Section 581 as intended.47

RECOMMENDATION 24: Appraise vessels at market value.50

RECOMMENDATION 25: Use the Board of Equalization's manufactured home unit cost tables as intended.51

RECOMMENDATION 26: Apply the inflation factor as required by section 75.18 for changes in ownership of manufactured homes that occur between January 1 and June 30.....52

RECOMMENDATION 27: Enroll manufactured homes as personal property.....52

RECOMMENDATION 28: Assess all taxable animals.....53

RECOMMENDATION 29: Develop formal procedures for the annual racehorse in lieu tax program.53

RESULTS OF 1998 SURVEY

Improvement Bonds

We recommended that the assessor obtain improvement bond information from the tax collector and auditor-controller. The assessor has implemented this recommendation.

Decline in Value

We recommended that the assessor adjust taxable values only when the change can be supported by market data. The assessor's decline-in-value program is now well organized and effective; thus, the assessor has implemented this recommendation.

California Land Conservation Act Properties (CLCA)

We recommended that the assessor: (1) assess trees and vines; (2) use the animal unit month value indicator in assessing grazing land; (3) deduct a charge from the income stream for return on and of investments in nonliving improvements; (4) deduct a capital replacement charge for irrigation wells; and (5) incorporate the current market value test for determining taxable value. The assessor has implemented items (1) and (5) of this recommendation. Additionally, the assessor has partially implemented item (3) in that he provides for a return on well costs. However, he still does not use the animal unit month value indicator in assessing grazing land or allow for a return of the investment of irrigation wells.

Taxable Government-Owned Properties (Section 11 Properties)

We recommended that the assessor consider the article XIII A limitation for properties subject to the provisions of article XIII, section 11 of the California Constitution. The assessor has implemented this recommendation. However, the assessor is not following recent BOE guidance regarding establishing base year values for such property.

Private Water Companies

For all private water companies, we recommended that the assessor develop value indicators based on both historical cost less depreciation and capitalized income. We also recommended reappraisal of a water company that underwent a change in ownership. Despite a reasonable effort, the assessor has been unable to obtain sufficiently detailed data from the water companies to develop reliable value indicators by the income approach. The assessor has reappraised the water company property that experienced a change in ownership.

Business Property Statement Processing

We recommended that the assessor: (1) use the equipment index and percent good factors in the Assessors' Handbook Section 581 (AH 581) as intended; (2) apply the index factors uniformly within similar business types; (3) screen property statements for authorized signatures; and (4) purge old data from the files. The assessor now screens property statements and periodically

purges old data from the business property files. However, items (1) and (2) have not been implemented and are again addressed in this survey report.

Apartment Personalty

We recommended that the assessor assess apartment personal property based on information provided on property statements and correctly apply the low-value ordinance to apartment personal property. The assessor still uses a fixed amount per unit to value apartment personal property and exempts from assessment any personal property for complexes of fewer than 15 units, regardless of whether the value of such property falls under the limit set by the county's ordinance for exempting low-valued property.

Leasehold Improvements

We recommended that the assessor improve the coordination between the business and real property divisions and that he assess all leasehold improvements uniformly. This recommendation has not been implemented.

Vessels

We recommended that the assessor value pleasure boats at market value. The assessor has not revised his policy on the valuation of vessels.

Computer Programs

We recommended that the assessor revise the procedures for assessing computer programs by: (1) assessing only basic operational programs; (2) establishing criteria for assessing computer software; and (3) explaining in the audit narrative and other work papers the basis for assessing basic operational programs. These recommendations have been implemented.

OVERVIEW OF SANTA CLARA COUNTY AND THE ASSESSOR'S OFFICE

Santa Clara County

Santa Clara County was admitted as one of California's original 28 counties on February 18, 1850. The county government was authorized by the State to deliver services, such as child welfare, jail and court administration, hospitals, schools, and road construction and maintenance. On April 23, 1850, the first Court of Sessions met and divided the county into five townships: San Jose, Santa Clara, Washington, Redwood, and Gilroy. Later, the townships of Almaden, Alviso, Burnett, Fremont, and Milpitas were added. Today, the center of county government is in San Jose.

The county encompasses 1,305 square miles, of which 353 square miles are within incorporated areas. Located in western-central California, Santa Clara County is bordered by the counties of Alameda to the north, Stanislaus and Merced to the east, San Benito to the south, and Santa Cruz and San Mateo to the west.

The Santa Clara Valley runs the entire length of the county from north to south, ringed by the Diablo Range on the east, and the Santa Cruz Mountains on the west. Salt marshes and wetlands lie in the northwestern part of the county, adjacent to the waters of San Francisco Bay.

Santa Clara County, the largest of the Bay Area Counties, has a population of almost 1.7 million, which places it fourth in terms of most populous following Los Angeles, San Diego, and Orange Counties.

Santa Clara County has a diversified economic business pattern, ranging from mining to manufacturing. The following table lists the top five industries based on total workforce:

INDUSTRY	NUMBER OF EMPLOYEES
Manufacturing	204,393
Professional, Scientific, and Technical Service	117,628
Administrative Support, Waste Management, and Remediation Services	92,066
Retail Trade	87,092
Health Care and Social Assistance	69,419

Assessor's Office

Budget

The assessor's budget for recent years is shown in the following table:

FISCAL YEAR	FINAL BUDGET	PERCENT CHANGE	TOTAL POSITIONS	PTAP POSITIONS
2003-04	\$30,671,366	10%	282	40
2002-03	\$27,796,720	(16%)	280	33
2001-02	\$32,295,904	13%	276	29
2000-01	\$28,041,595	24%	274	28
1999-00	\$21,359,679	7%	272	21

Workload

The assessor produced a local assessment roll for 2002-03 consisting of 534,379 assessment parcels (448,591 on the secured roll and 85,788 on the unsecured roll). This assessment roll had a gross taxable value of \$218,112,084,020, which was an increase of 5.53 percent over the 2001-02 roll total of \$206,674,948,237. The following table displays property type, number of assessments, and enrolled value information pertinent to the 2002-03 assessment roll:

PROPERTY TYPE	NUMBER OF ASSESSMENTS	ENROLLED VALUE
<u>Secured Roll</u>		
Residential	405,277	\$127,752,159,044
Commercial/Industrial	27,851	62,696,883,273
Rural	6,553	1,603,368,358
Manufactured Homes	8,910	477,550,418
Total Secured	448,591	\$192,529,961,093
<u>Unsecured Roll</u>		
	85,788	\$25,582,122,927
Total Assessment Roll	534,379	\$218,112,084,020

The following table shows the distribution of property types assessed on the secured roll in the current and prior years:

ROLL YEAR	NUMBER OF SECURED ROLL UNITS			
	RESIDENTIAL	COMMERCIAL	RURAL	MANUFACTURED HOMES
2002-03	405,277	27,851	6,553	8,910
2001-02	403,012	28,326	6,536	8,557
2000-01	400,492	28,263	6,450	7,790
1999-00	397,438	28,912	6,791	7,322

The next table illustrates the growth in assessed values during the past several years:

ROLL YEAR	TOTAL ROLL VALUE	INCREASE
2002-03	\$218,112,084,020	5.53%
2001-02	\$206,674,948,237	15.22%
2000-01	\$179,372,581,153	9.69%
1999-00	\$163,532,777,256	---

The 2002-03 real property workload consisted of approximately 25,500 changes in ownership and 13,812 assessments of new construction. The roll included 2,500 taxable possessory interests, 3,920 California Land Conservation Act (CLCA) parcels, and 29,014 decline-in-value assessments. The assessor also completed a business property workload that included approximately 98,000 business property statement reviews (both secured and unsecured) including approximately 8,900 manufactured homes, 1,250 audits (approximately 1,090 mandatory and 160 nonmandatory), 4,720 vessel assessments, and 1,020 aircraft assessments.

Staffing

The assessor's office has 247 general fund budgeted full-time positions, including the assessor. There are also 33 full-time PTAP positions and 7.7 seasonal extra help full-time equivalent positions. At the time of our survey fieldwork, some of these positions were vacant. The assessor does not use contract employees. A chief appraiser and an assistant chief appraiser manage the real property division. The remainder of the division consists of seven supervising appraisers, 27 senior appraisers (two half-time codes), and 38 journey level appraisers (two half-time codes) The half-time codes include 2 senior appraisers, one appraiser and one auditor appraiser. Three appraisal aides assist the certified appraisers in the performance of their duties.

The appraisal staff, including the appraisal aides, are assigned to seven different appraisal districts. The districts are defined by property type and geographic location. In addition to other responsibilities, one real property appraiser is responsible for the CLCA program, a supervising real property appraiser administers the taxable government-owned property program, one senior

real property appraiser is responsible for the discovery and valuation of taxable possessory interests, and one supervising appraiser is assigned the valuation of pipeline rights-of-way.

The business property division consists of a chief auditor-appraiser, assistant chief auditor-appraiser, six supervising auditor-appraisers, 25 senior auditor-appraisers, and 16 journey level auditor-appraisers. One supervising auditor-appraiser and an appraisal technician are responsible for the assessment of all aircraft and vessels; and one supervising auditor-appraiser and an appraisal technician value all manufactured homes.

The following table shows the remaining staff positions for fiscal year 2002-03 including PTAP positions, and the number of employees in each classification (some positions, although budgeted, were not filled at the time of our fieldwork):

CLASSIFICATION	NO.
Admin. Services Manager	1
Info. Systems Manager II	2
Program Manager II	1
Senior Management Analyst	5
Assessment Roll Administrator	1
Confidential Secretary	1
Info. Sys. Technician II	1
Office Management Coordinator	1
Sup. Appr. Data Coordinator	1
Senior Property Mapper	1
Property Mapper II	6
Appraisal Data Coordinator	8
Advanced Clerk Typist	4
Account Clerk II	1
Assessment Clerk	26
Clerk Typist	27
Receptionist	1

CLASSIFICATION	NO.
Assessor's Office Info. Sys. Director.	1
Info. Systems Manager I	9
Dept. Info. Systems Analyst II	1
Exemption Administrator	1
Exemption Investigator	1
Map/ID Supervisor	1
Prop. Transfer Supervisor	1
Supervising Assessment Clerk	4
Personnel Services Clerk	1
Property Transfer Examiner	9
Accountant Assistant	6
Property/Title ID Clerk	8
Senior Assessment Clerk	9
Account Clerk I	1
Office Clerk	3
Geographical Technician II	1

ADMINISTRATION

This portion of the survey report focuses on administrative policies and procedures of the assessor's office that affect both the real property and business property assessment programs. We examined the State-County Property Tax Administration Program, appraiser certification, standards and quality control, exemptions, disaster relief, low-value property exemptions, and assessment forms. We also reviewed how the assessor processes corrections and changes to the completed assessment roll, and how the assessor prepares for and presents assessment appeals.

The assessor's stated mission is to produce an annual assessment roll including all assessable property in accordance with legal mandates in a timely, accurate and efficient manner; and provide current assessment-related information to the public and to government agencies in a timely and responsive way. With a staff of 280 full-time employees, the assessor administers an assessment roll of more than 534,000 properties. As noted previously, the assessor completed the assessment roll timely and under budgeted costs for the 2001-02 fiscal year.

State-County Property Tax Administration Program

In 1995, the Legislature established the State-County Property Tax Administration Program (PTAP). This program, which was later entitled the State-County Property Tax Administration Loan Program, provided state-funded loans to eligible counties for the improvement of property tax administration.²

If an eligible county elected to participate, the county and the State Department of Finance entered into a written contract, as described in section 95.31. A PTAP loan is considered repaid if the county satisfies agreed-on performance criteria set forth in the contract. The contract provides that the county must agree to maintain a base funding and staffing level in the assessor's office equal to the funding and staffing levels for the 1994-95 fiscal year. This requirement prevents a county from using PTAP funds to supplant the assessor's existing funding.

For most counties, the contract provides that verification of performance is provided to the State Department of Finance by the county auditor-controller.

Santa Clara County has participated in the PTAP every year since its inception. For the fiscal year 2001-02, the State and county agreed to PTAP funding of \$4,213,639. This level of funding will continue each year until the agreement expires December 30, 2004. Throughout the program, the assessor has maintained his staffing at the minimum level (242 positions) or higher, as required by the contract.

In a report to the Department of Finance dated February 28, 2002, the assessor reported the following achievements under the PTAP funding:

² The State-County Property Tax Administration Loan Program expired June 30, 2001. In 2001, the Governor approved AB 589 (Chapter 521, Statutes of 2001), establishing the State County Property Tax Administration Grant Program for the fiscal years 2002-03 through 2006-07. The new grant program operates in essentially the same manner as the loan program except that if a county fails to meet its contractual performance criteria, the county will not be obligated to repay the grant but will be ineligible to continue to receive a grant.

- The business division was successful in retaining 89.89 percent of the assessed value in dispute for all assessment appeals included in the program;
- Audits completed resulted in more than \$2.3 billion of value enrolled;
- Deed processing workload was reduced by 91,583 deeds (this represents 80.1 percent of the total deeds on hand and the deeds filed as of December 31, 2001);
- The business property division's discovery program resulted in the enrollment of \$171 million in assessed value; and,
- E-filing of business personal property statements was launched, allowing 30,000 small businesses to file on-line through the assessor's web site.

Santa Clara County authorized 26 "unclassified" positions to augment the assessor's staff in order to meet the terms and performance objectives contained in their agreement with the Department of Finance. The positions included two real property appraisers, four auditor-appraisers, one supervising appraiser, one supervising auditor-appraiser, two accountant assistants, three appraisal support staff, five assessment clerks, four property transfer examiners, one supervising assessment clerk, one senior management analyst, and two information systems technicians.

The County of Santa Clara's Finance Agency, Internal Audit Division, has verified the assessor's performance of the contract requirements.

Appraiser Certification

Section 670 requires any person who performs the duties of an appraiser to hold a valid certificate issued by the BOE. The assessor and his staff possess the required certificates.

The Santa Clara Assessor has 125 BOE-certified staff members, all of whom hold permanent appraiser's certificates: 48 auditor-appraisers (13 of whom hold advanced appraiser certificates) and 77 real property appraisers (44 of whom hold advanced certificates). There are no employees who possess a temporary appraiser's certification.

While the assessor's appraisal staff is in compliance with statutory appraiser certification requirements, one issue involving certification does exist.

RECOMMENDATION 1: Use certified appraisers to value aircraft and vessels.

An appraisal technician processes all aircraft and vessel statements, and calculates an indicated value for each type of property. The calculated values are then placed on the assessment roll. While it is the official policy of the assessor to have a certified auditor-appraiser review and approve the appraisal technician's indicated values, we confirmed that a certified auditor-appraiser does not review any of the assessments.

Section 670 requires that all persons who perform the duties or exercise the authority of an appraiser for property tax purposes must hold a valid appraiser's or advanced appraiser's certificate issued by the BOE. The appraisal technician who processes the aircraft statements

does not hold such a certificate. Thus, a certified auditor-appraiser must review and approve the indicated values.

We recommend that the assessor ensure that all aircraft and vessel valuations are made by or approved by a certified auditor-appraiser.

Standards and Quality Control

Standards and quality control functions ensure the consistency and quality of the appraisal product or taxpayer services through the development and maintenance of appraisal and operating standards. Other duties of a standards and quality control unit may include training, legal interpretations, or data processing coordination.

Procedures Manuals

Formal written guidelines can be useful to ensure continuity and standardization within the appraisal process, and to provide equal treatment for all taxpayers. They also play an important role in the orientation and training of new staff members.

An eight-volume policy and procedures manual governs the day-to-day operation of the Santa Clara County Assessor's Office. The volumes include sections covering general policies, administration, assessment services, assessment standards, valuation, real property, business property, and exemptions. The manuals are informative and up-to-date.

Review of Completed Work

For the most part, the assessor has an effective system of ensuring quality in the work product in his office. When work is completed, it is submitted to the supervising appraiser, who reviews it to ensure that it conforms to property tax law and that it contains proper documentation. After the supervising appraiser approves the appraisal, the file goes to the assessment clerk for data entry. In addition to data entry, the clerk also checks for computational errors. If an error is found, the clerk returns the appraisal file to the supervising appraiser for correction. In the end, no fewer than three reviews of each appraisal are conducted.

Exemptions

The assessor's exemption section consists of an exemption administrator, a supervising assessment clerk, three senior assessment clerks, three assessment clerks, two clerk-typists, and one exemptions investigator. This section processes all exemption claims, including over 285,000 homeowners' exemption claims. When field inspections of exempt properties are required, they are conducted by the unit administrator or exemptions investigator.

Welfare Exemption

The welfare exemption is available for property used exclusively for religious, hospital, scientific, or charitable purposes that is owned and operated by community chests, funds, foundations, or corporations organized and operating for those purposes. If the property is owned

by one qualified organization and used by another qualified organization more than once per week, then both must file a claim for the property to receive an exemption.

The welfare exemption is co-administered by the BOE and county assessors, and the claim must be approved by both agencies. Annual filing of the exemption claim with the assessor is required. The assessor reviews the claim and forwards a copy to the BOE. BOE staff reviews the claim and notifies the assessor of approval or denial.

When the welfare exemption is claimed on a property for the first time, copies of the organization's articles of incorporation, tax-exempt letters, and financial statements must be submitted with the claim. The assessor reviews the claim form and the attached documents for completeness and compliance with the requirements for exemption. The assessor also performs a field inspection to verify that the information on the claim form is correct and the property is used exclusively for religious, hospital, scientific, or charitable purposes and activities. When the claim form, other required documents, and field inspection are complete, the assessor forwards a copy of those items to the BOE along with a recommendation for approval, partial approval, or total denial.

An assessor cannot grant a welfare exemption that has been denied by the BOE, but may deny an exemption that was approved by the BOE.

We reviewed a variety of welfare exemption claims on file at the assessor's office. We concentrated our review on claims that contained special findings, including but not restricted to the following:

- First-time filings (new claims);
- Claims denied for any reason;
- "Late filed" claims; and,
- Mid-year acquisitions eligible for cancellation or proration of taxes pursuant to section 271.

Specific property types that we reviewed include:

- Low-income housing and hospitals (partial exemptions);
- Reasonably necessary staff housing, including parsonages;
- Religious schools;
- Private schools;
- Multispecialty health care clinics; and,
- Exempt organizations subject to mandatory audit pursuant to section 469.

The assessor maintains well-documented exemption claims. There is a permanent file and a field folder for every organization. The computer database has extensive cross-referencing showing other exempt users of an exempt organization's property, an exemption history, and calculations of exempt values, whether full or partial. Exempt organizations owning trade fixtures and tangible business personal property having a full value of \$400,000 or more for four consecutive years are audited regularly as required by law. All statutory provisions are appropriately applied and claims are correctly processed.

The following table summarizes welfare exemptions granted on the local roll for the last five years:

ASSESSMENT YEAR	NUMBER OF EXEMPTIONS	VALUE EXEMPTED
2002-03	1,456	\$3,051,596,569
2001-02	1,194	\$2,765,371,022
2000-01	1,179	\$2,323,569,385
1999-00	1,307	\$2,073,971,680
1998-99	870	\$1,952,451,400

The assessor maintains an effective welfare exemption program.

Church and Religious Exemptions

The church exemption is authorized by article XIII, section 3(f) of the California Constitution. This provision, implemented by section 206, exempts from property taxation buildings, land on which they are situated, and equipment used exclusively for religious worship, whether such property is owned by the church or leased to it. Property that is reasonably and necessarily required for church parking is exempt under article XIII, section 4(d), provided the property is not used for commercial purposes. The church parking exemption is available for church-owned property as well as leased property meeting the requirements in section 206.1.

Article XIII, section 4(b), authorizes the Legislature to exempt property used exclusively for religious, hospital or charitable purposes and owned or held in trust by corporations or other entities that meet the following requirements: (1) are organized and operated for those purposes; (2) are non-profit; and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual. The Legislature has acted upon such authorization by enacting the religious exemption in section 207 of the Revenue and Taxation Code, which exempts property owned by a church and used exclusively for religious worship and school purposes.

The assessor administers the church and religious exemptions. The church exemption and the church parking exemption require an annual filing of the exemption claim. However, the religious exemption requires a one-time filing by the claimant. Once granted, the exemption remains in effect until terminated or until the property is no longer eligible for the exemption.

The following table represents the number of religious exemptions and assessed values for the last five years:

ASSESSMENT YEAR	NUMBER OF EXEMPTIONS	VALUE EXEMPTED
2002-03	679	\$414,151,678
2001-02	496	\$391,073,370
2000-01	515	\$366,845,884
1999-00	606	\$346,971,102
1998-99	551	\$340,936,848

Our review of the assessor's religious exemption program discovered a few claims where there was a question as to qualifying use. The assessor scheduled field inspections to make a proper determination of current eligibility for exemption. The assessor maintains an effective religious exemption program.

The following table represents the number of church exemptions and assessed values for the past five years:

ASSESSMENT YEAR	NUMBER OF EXEMPTIONS	VALUE EXEMPTED
2002-03	216	\$89,728,478
2001-02	225	\$94,269,004
2000-01	221	\$83,304,659
1999-00	210	\$79,915,620
1998-99	220	\$80,140,675

Our review of the assessor's church exemption program showed no significant deficiency. As with the religious exemption claims, we found isolated cases of potentially disqualifying uses; however, the assessor promptly scheduled field inspections to resolve the matter.

Disaster Relief

Section 170 authorizes a county board of supervisors to adopt an ordinance that provides property tax relief to assessees whose properties have been damaged or destroyed by a misfortune or calamity. The ordinance may apply to any qualifying misfortune or calamity, to a major misfortune or calamity within a region that has been declared by the Governor to be in a state of disaster, or to a misfortune or calamity that was caused by the suspension or restriction of the right to enter upon a possessory interest in state or federal government-owned land.

To qualify for disaster relief, the property must suffer a misfortune or calamity in which the amount of damage exceeds \$10,000. To obtain relief under this ordinance, the assessee must timely file a written application requesting reassessment.

The board of supervisors has adopted a disaster relief ordinance that provides relief for any taxable property that is damaged or destroyed by misfortune or calamity. The ordinance was updated March 26, 2002, to reflect changes to section 170. The new ordinance, effective January 1, 2002, increased the amount of damage required for eligibility from \$5,000 to \$10,000 of assessed value, extended the time period to file for a reassessment from 6 months to 12 months, and expanded the deadline for filing an appeal from 14 days to 6 months.

From January 2001 to July 2002, the assessor mailed 307 applications, of which 70 were returned to the assessor. The assessor processed disaster relief for 17 of these claims. We reviewed eight of the 17 claims and found that the assessor handled each case properly. The county completes an average of 12 claims per year.

Fire Reports

RECOMMENDATION 2: Obtain fire reports from local fire departments to discover property damaged or destroyed by a misfortune or calamity.

In our prior survey, we suggested that the assessor obtain fire reports from all fire departments within the county. The assessor still does not receive fire reports. Instead, the assessor discovers fire-related disasters through newspaper articles, taxpayer notification, and building permits issued for repairs or demolition.

Official fire reports are a valuable resource for discovering damaged or destroyed properties. For example, we obtained a list of fire inspections by address and damage in excess of \$20,000 from the Santa Clara County Fire Department. Several properties on this list were not identified by the assessor as being eligible for disaster relief.

We recommend that the assessor obtain fire reports from local departments on a regular basis.

Restricted Access

RECOMMENDATION 3: Grant disaster relief for all qualifying misfortunes or calamities, as provided in rule 139.

The assessor denies applications for relief for disasters resulting in restricted physical access. Under section 170, qualifying "damage" includes a diminution in value resulting from restricted access caused by a misfortune or calamity. Rule 139, adopted June 15, 2002, by the BOE, clarified that "restricted access" includes a suspension of normal business activities as a result of compliance with a governmental action. An example in rule 139 specifically illustrates the application of section 170 to the airport closures following the terrorist attacks of September 11, 2001. Consequently, airlines and airport-related businesses whose claims have been denied may qualify for disaster relief.

We recommend the assessor grant all disaster relief for qualifying misfortunes or calamities as provided in section 170 and rule 139.

Low-Value Property Exemption

Section 155.20 authorizes the county board of supervisors to exempt from property taxation all real property with a base year value and personal property with a full value so low that, if not exempt, the total taxes, special assessments and applicable subventions on the property would amount to less than the assessment and collection costs. Section 155.20(b)(1) provides that the county board of supervisors has no authority to exempt property with a total base year value or full value of more than \$5,000, or more than \$50,000 in the case of certain possessory interests. The board of supervisors must adopt any such exemption before the lien date for the fiscal year to which the exemption is to apply. At the option of the board of supervisors, the exemption may continue in effect for succeeding fiscal years.

In our prior survey, we recommended that the assessor request the Santa Clara County Board of Supervisors to amend the county's low-value property exemption ordinance to include all classes of property and to reflect current exemption limits. The board of supervisors, upon the recommendation of the assessor, amended its ordinance, which increased qualifying property value from \$2,000 to \$5,000. The amended ordinance still applies only to personal property.

RECOMMENDATION 4: Properly apply the low-value property exemption.

The assessor does not properly implement the low-value property exemption. Specifically, the assessor exempts aircraft with values greater than \$5,000 and possessory interest assessments having a taxable value of \$2,000 or less.

The exemption ordinance applies only to personal property with an assessed value of \$5,000 or less. Thus, the assessor has no authority to exempt aircraft with a value greater than \$5,000. In addition, possessory interests are interests in real property and are classified as real property. The assessor has no authority to apply the exemption to real property, including possessory interests, regardless of the assessed value. The assessor's practice regarding low-valued aircraft and possessory interest assessments is contrary to the county ordinance.

We recommend that the assessor properly apply the low-value property exemption.

Assessment Forms

RECOMMENDATION 5: Use the correct version of BOE-prescribed forms.

Two BOE-prescribed forms used by the assessor are incorrect versions of these forms. In addition, the assessor's Web site contains an outdated form.

Subdivision (d) of Government Code section 15606 requires the BOE to prescribe and enforce the use of all forms for the assessment of property for taxation.³ The BOE currently prescribes 74

³ Also, Revenue and Taxation Code sections 480(b), 480.2(b), 480.4 and California Code of Regulations (property tax rules) sections 101 and 171.

forms for use by county assessors and one form for use by county assessment appeals boards. Generally, the assessor has the option to change the appearance (e.g., size and color) of a prescribed form but cannot add to, change, or delete prescribed language. The assessor may also rearrange the layout of a form if prior approval is obtained from the BOE.

Assessors may also use locally developed forms to assist them in their assessment duties. However, such forms may not be used as substitutes for BOE-prescribed forms, and no penalty may be imposed upon a property owner for failure to file such a form or questionnaire.

The BOE revises forms in response to legislative changes, among other reasons. Failure to use correct versions of BOE forms may result in taxpayers not receiving the full benefits to which they are entitled.

We recommend that the assessor use the correct versions of BOE-prescribed forms.

RECOMMENDATION 6: Timely return all forms checklists to the BOE.

Of the forms checklists required to be submitted to the BOE for approval, the assessor's only timely submission was his property statement checklist. He submitted the exemption claim checklist late and did not submit the miscellaneous forms checklist, at all.

The BOE annually sends to assessors checklists for property statements, exemption forms, and miscellaneous forms. Assessors are to indicate on the checklists which forms they will use in the succeeding assessment year; the checklists for property statements and miscellaneous forms must be returned by October 15, and the exemption forms checklist must be returned by December 1. Assessors are also required to submit to the BOE the final prints of all forms they will use by February 10.

We recommend that the assessor return all forms checklists to the BOE in a timely manner.

RECOMMENDATION 7: Submit final prints of all forms as required by rule 171(a).

The assessor did not submit final prints of any forms to the BOE. The assessor reported to the BOE that he would use 45 of the 58 BOE-prescribed property statements, miscellaneous, and exemption claim forms, and that six of these would be submitted in rearranged format. Although the assessor submitted draft forms for approval he never submitted a final copy of the printed forms.

Pursuant to rule 171(a), assessors are required to submit to the BOE, by February 10, each year, the final printed copies of all forms they will use. Submission of the final forms helps to eliminate any errors prior to their use.

We recommend that the assessor submit copies of all final printed forms.

Assessment Roll Changes

The assessor has a duty to complete the local assessment roll and deliver it to the auditor by July 1 of each year. After delivery to the auditor, the assessment roll may not be changed except as authorized by statute or by the board of supervisors. All assessment roll changes are based on specific statutes, and any roll change must be accompanied by the appropriate statutory reference.

Assessment roll changes fall under two general categories: escape assessments and corrections. An escape assessment is an assessment of property that was not assessed or was underassessed on the original roll, for any reason. A correction is any type of authorized change to an existing assessment except for an underassessment caused by an error or omission of the assessee.

The following table shows the number of roll changes processed over a four-year period:

ROLL YEAR	ROLL CHANGES
2001-02	12,144
2000-01	20,160
1999-00	19,438
1998-99	22,264

In the Santa Clara County Assessor's Office, assessment roll changes are initiated by various staff members, reviewed by the supervisor, and approved by the manager or assistant manager of the division generating the roll change. Roll changes are logged for tracking purposes and forwarded to the Tax Roll Control unit of the Finance Department for processing.

The assessor's roll corrections are made within the period of time required by law. *Notices of Proposed Escape Assessment* are mailed to taxpayers at least 10 days before the changes are entered on the roll.

RECOMMENDATION 8: Correctly identify penalty and escape assessments on the current assessment roll, as required by section 533 and rule 261.

On the current assessment roll, the assessor does not include the notation required by section 533 or the penalty identification required by rule 261. Section 533 requires the assessor to enter an escape assessment on the roll for the current assessment year. If the escape is for a prior roll, the entry on the current roll must state "Escaped assessment for year [20]__ pursuant to Sections ___ of the Revenue and Taxation Code." This notation provides notice of escape assessment to the public.

Rule 261 provides that when penalties are imposed under section 463, notice on the local roll is required. Rule 261 requires the assessor to enter section 463 penalty assessments on the local roll in one of three ways:

- 1) Adding appropriate penalties to the assessed value of each class of property to which the penalty is applicable and referencing the values to footnotes or entries in the remarks column or other columns which reads: "Includes__% penalty added pursuant to Sec _____, R & T Code."
- 2) Inserting the amount to be added to the assessed value of each class of property below the assessed value and identifying the penalty by an entry on the same line but in another column or other columns which reads: "Penalty added pursuant to Sec. _____, R & T Code."
- 3) Entering the amount to be added to the assessed value of each class of property in another part of the roll, together with the name and address of the assessee, the tax-rate area code, the words "penalty added pursuant to Sec. _____, R & T Code" and a cross reference to the place on the roll at which the assessed values are entered.

The consequence of this omission is that an explicit statutory requirement for escape assessments has not been met. It should be noted, however, that this requirement does not apply to corrections that reduce the assessed value on the roll.

We recommend that the assessor correctly identify penalties and escape assessments on the current roll as required by section 533 and rule 261.

Assessment Appeals

The assessment appeals function is prescribed by article XIII, section 16 of the California Constitution. Sections 1601 through 1641.2 are the statutory provisions governing the conduct and procedures of assessment appeal boards and the manner of their creation. As authorized by Government Code section 15606, the BOE has adopted rules 301 through 326 to regulate the assessment appeals process.

Santa Clara County Ordinance NS-300-247, adopted August 8, 1977, provides for the creation of the county's assessment appeals board and defines its duties. Currently, there are two appeal boards. Each board consists of three members who are appointed by the board of supervisors. Assessment appeals board hearings are held on the second and fourth Wednesday of each month. There is also one hearing officer, who meets with the assessor's staff and appeal applicants the third Wednesday of each month.

Applications are received by the clerk of the assessment appeals board, reviewed and verified, and forwarded to the assessor's assessment standards division. The assessment standards division also reviews and verifies the applications and forwards a copy to the real property, personal property, or assessment services division, as appropriate.

The assessor prepares draft responses and contacts applicants by telephone. If the applicants decide to withdraw their appeal or agree to a stipulated value, the assessor sends a letter for their signature. Upon receipt of the signed letter, the appeal is officially withdrawn, or in the case of a stipulation, the letter is forwarded to the assessment appeals board for approval. If no agreement can be reached, the appeal process continues and a hearing is scheduled.

The assessor receives monthly updates that track the progress of assessment appeals. In the last five years, no appeal has gone unresolved for more than two years unless the taxpayer agreed to an extension of the two-year statute of limitations provided for in rule 309(b). About 90 percent of appeals are completed in the first year. Approximately 2,000 appeals are filed annually.

The following table shows the breakdown of appeal findings over the last five years:

APPEAL RESULTS	2001-02	2000-01	1999-00	1998-99	1997-98
Board Determined	24	151	119	104	132
Withdrawn	623	1,247	1,298	1,508	3,047
Application Denied	19	26	18	16	18
Stipulated by Assessor	104	274	342	313	696
Pending Resolution	1,258	0	0	0	0
TOTAL	2,028⁴	1,698	1,777	1,941	3,893

As evidenced by the high percentage of withdrawn applications and value stipulations, the assessor is diligent in his efforts to reconcile differences in opinions of value.

Over the last five years, approximately 40 percent of the appeals involved business property, 28 percent involved commercial or industrial properties, and 23 percent involved single-family residential properties. The remaining appeals involved a mixture of other property types.

During our current survey we reviewed the records for seven assessment appeals. We found them to be well documented and complete.

Overall, the assessor's portion of the assessment appeal program is well administered. The staff handling appeals is experienced and well prepared, and works well with the assessment appeals board.

⁴ For 2001-02, there were 2,028 total appeals filed. However, only 770 had been completed by the time the field work for this survey report had ended.

ASSESSMENT OF REAL PROPERTY

An assessor's program for assessing real property includes the following elements:

- Revaluation of properties that have changed ownership.
- Valuation of new construction.
- Annual review of properties that have experienced declines in value.
- Annual revaluations of certain properties subject to special assessment procedures, such as land subject to California Land Conservation Act (CLCA) contracts and taxable government-owned land.

Under article XIII A of the California Constitution, the taxable value of most real property may not exceed its full cash value as of the later of (1) the 1975 lien date or (2) the property's most recent change in ownership or completion of new construction. This ceiling on taxable value establishes the property's "base year value," which is subject to an inflation adjustment not to exceed 2 percent per year.

Change in Ownership

Section 50 requires the assessor to establish a base year value for real property upon a change in ownership. Section 60 defines change in ownership as a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee simple interest. Sections 61 through 69.5 further clarify what is considered a change in ownership and what is excluded from change in ownership for reappraisal purposes.

The Santa Clara County Assessor annually receives approximately 80,000 recorded documents. These documents are pre-screened by the recorder to determine potential changes in ownership based on a list of document types provided by the assessor. Approximately 40 percent of these documents result in a reassessable event. At the time of our survey, the backlog for processing documents was about two months, with a backlog of six to eight weeks being typical.

A history of the number of reappraisals resulting from changes in ownership and their effect on the assessment roll over the last three years is shown below:

FISCAL YEAR	2002-03	2001-02	2000-01
Units To Be Reappraised	25,466	31,153	38,304
Incomplete Reappraisals	25	344	171
Net Change in Roll	\$10,087,723,177	\$14,102,490,212	\$9,133,005,308

The above information for 2002-03 is broken down by property type as follows:

CLASSIFICATION	ROLL UNITS	NET CHANGE
Residential	23,583	\$6,947,217,765
Commercial	1,285	\$2,900,891,096
Rural	558	\$191,489,027
Manufactured Homes	40	\$48,125,289

Assessor's parcel numbers (APN's) are not noted on documents received from the recorder. There is no county ordinance requiring the recorder to make such an annotation. The assessor's assessment roll administration division identifies the parcel numbers of the transferred real property.

When the deeds are received from the recorder, most are first sent to the ownership identification unit, which inputs ownership information into the assessor's computer system. This unit also determines the APN's for properties where the deeds identify properties by only their legal descriptions. Deeds that create lot line adjustments, lot splits or other newly created parcels, or which include metes and bounds descriptions, are forwarded to the mapping unit, which supplies the APN's and then sends the documents back to the ownership identification unit. The situs control unit is responsible for placing addresses on new parcels and for processing address changes.

Homeowners' exemptions are automatically removed following a change in ownership. Where staff determines that the transferee might be eligible for this exemption, the deeds are directed to the exemptions division to determine whether the exemption should be granted to the new owner.

Deeds that involve partnerships, corporations, trusts, parent-child transfers, and other more complex transactions, are routed through the property transfer unit for more intensive review.

The standards division reviews all decisions made by the transfer analysis staff. This information is used to generate the Parcel Activity List (PAL) that is given to appraisers to notify them of reappraisable events.

Approximately 90 percent of the deeds received from the recorder have Form BOE-502-A, *Preliminary Change of Ownership Report* (PCOR), attached. As required by law, both the assessor and the recorder make the PCOR form available upon request. The form is also available online. The recorder charges a \$20 fee when a deed is recorded without a PCOR.

In every instance where a PCOR is not provided, or is not completed in its entirety, the standards division sends the buyer a sales verification letter tailored to the type of property that transferred. They send an additional letter to buyers of multiple family, commercial, and industrial properties, requesting more comprehensive income information. If the taxpayer does not respond within 30 days, the staff sends a second request. Roughly 90 percent of the buyers of residences respond to these questionnaires, while at least 75 percent of the commercial and industrial

purchasers reply. Because these forms are not BOE-prescribed, no penalty is imposed if a taxpayer does not file the form.

If a PCOR or sales verification letter indicates a sale involved unusual financing, a trade, or included personal property, the standards division sends a hard copy of the document to the appraiser, who is responsible for determining if a cash equivalency adjustment is justified.

The standards division also receives annual updates from the various bond-issuing agencies in the county showing outstanding improvement bond balances for encumbered properties. Additionally, this division compiles information on outstanding bonds that have been reported on the PCOR or sales verification letter. Appraisers have access to this information on the assessor's computer system.

Based on paired-sales analysis, the assessor has determined that outstanding bond balances should, in general, be added to sales prices. However, the appraiser makes the ultimate decision based on current market data and may elect to not add the present value of the unpaid bonds.

Section 408.1 Transfer Lists

The assessor makes available to the public a listing on microfiche showing property transfers that have occurred over the last two years. This list is updated quarterly. Properties are listed in parcel number order, and the listing includes the name of the transferee, APN, transfer date, recording document number, verified sale price, sale price indicated by the transfer tax, and a land use code.

RECOMMENDATION 9: Include only that information on the list of transfers that is required by section 408.1.

The assessor's transfer list is not divided into geographical areas, and it does not include the name of the transferor, the address of the property that sold, or the recording date. However, it does include the indicated sale price, based on documentary transfer stamp indication, and other required information. In addition to the indicated sales price, the assessor also includes the confirmed sale price as reported on the PCOR.

Section 408.1 requires that the assessor maintain and make available to the public a list, divided into geographical areas, that shows property transfers that have occurred in the prior two years. In addition, the list must include the transferor and transferee if available, assessor's parcel number, address of the sales property, date of transfer, date of recording and recording reference number, and, where it is known by the assessor, the consideration paid.

However, section 408.1(f) states that the assessor must not include information on the transfer list that was furnished on a BOE-prescribed change in ownership statement. Additionally, section 481 states that all information furnished in the COS or PCOR must be held secret by the assessor. These statements are not public documents.

We recommend that the assessor include on the transfer list all of the information required by section 408.1 and exclude any confidential information reported on the PCOR.

Legal Entity Ownership Transfers (LEOP)

Section 64(c) provides that certain transfers of ownership interests in legal entities are changes in ownership of all real property owned by the entity and its subsidiaries. Rule 462.180 provides a detailed interpretation of section 64, including the application of certain exclusions. Discovery of such changes in ownership is difficult because ordinarily there is no recorded notice of the transfer.

The BOE's LEOP unit investigates and verifies changes in control and ownership reported by legal entities and transmits to each county a listing, with corresponding property schedules, of the entities that have reported a change in control under section 64(c) or change in ownership under section 64(d). However, many of the acquiring entities do not provide detailed information pertaining to the counties in which they have property (e.g., the assessor's parcel number and how many parcels they own). Because of the lack of reliable data provided by the entities, the LEOP unit advises assessors to thoroughly research each named entity's holdings to ensure that all affected parcels are identified and properly appraised.

From January 1997 to January 2001, the LEOP unit notified the Santa Clara County Assessor of changes in control of 102 legal entities, which own about 1,320 parcels. We reviewed 27 changes in control of legal entities reported to the assessor and found that the assessor took appropriate action in reviewing and reappraising the real property parcels acquired by these entities.

Direct Enrollment

Direct enrollment is a program used in many assessor's offices to streamline the processing of uncomplicated transfers of residential properties. It requires limited review by the appraisal staff of confirmed sales that meet certain parameters. In Santa Clara County, the assessor's direct enrollment program is only used to enroll qualifying single-family residences, including condominium units. Among the parameters that a property must meet to qualify for direct enrollment are:

- The transfer must involve a 100 percent interest,
- The deed must show a transfer tax based on the full sale price,
- The improvements must exceed 300 square feet,
- The sale price must be less than \$1,000,000,
- The site must be less than 2.3 acres, and
- The sale price must exceed the current assessed value.

The assessor has divided the county into eight market areas in which market studies are conducted to determine if individual sale prices are within an acceptable range of values. The sales used to estimate market values are updated every four months and are generally no longer considered if they are more than one year old.

If the appraiser accepts a sale price as reasonable and appropriate for direct enrollment, he or she is given four options for allocating the sale price between land and improvements:

- Allocate based on a percentage of the sale price;
- Allocate based on the existing assessed values' land to improvement ratio;
- Allocate a flat dollar amount to the land and assign the residual value to the improvements;
or
- Value the land based on a price per square foot and allocate the residual value to the improvements.

The most current statistics available indicate that the assessor enrolls approximately 50 percent of the eligible changes in ownership in this manner. We found no problems with the assessor's direct enrollment program.

New Construction

For newly constructed real property, section 71 requires the assessor to determine a new base year value upon the date of completion of construction. If the new construction is in progress on the lien date, it is valued at its current market value. Rule 463 governs the assessment of new construction by interpreting and making more specific the requirements of section 71. Chapter 6 of Assessors' Handbook Section 502, *Advanced Appraisal*, provides additional guidance for assessing new construction.

Discovery

Most new construction activity is discovered from building permits. Currently, the assessor receives an average of about 30,000 permits annually from 16 permit-issuing agencies. The agencies are the cities of Campbell, Cupertino, Gilroy, Milpitas, Monte Sereno, Morgan Hill, Mountain View, Palo Alto, San Jose, Santa Clara, Saratoga, and Sunnyvale; the towns of Los Altos and Los Gatos; the County of Santa Clara; and the county Department of Health Services. Other discovery methods include newspaper articles, business property statements, and field canvassing. The following table shows assessor's building the permit workload.

TAX YEAR	TOTAL NUMBER OF PERMITS RECEIVED	NUMBER OF PERMITS RESULTING IN NEW CONSTRUCTION	TOTAL VALUE ADDED
2002-03	28,200	13,812	\$ 3,660,163,625
2001-02	31,153	15,044	\$ 3,968,250,183
2000-01	31,495	14,385	\$ 3,405,948,694

Permit Processing

The assessor receives copies of building permits or a list of all building permits issued on either a weekly or monthly basis, depending on the issuing agency. Clerks enter all pertinent data into the computer system for all building permits except those that are strictly for mechanical, plumbing, and electrical work. This establishes a listing of building permits by appraisal district.

The appraiser receives the building permit, the updated property record, a field sheet, and his or her PAL for the current year. The PAL shows those permits that have been completed or partially completed, as well as those permits for which no value was added. The real property division notifies the business division, by a referral slip, of any building permit activity indicating leasehold improvements.

Self-Reporting Program

In an effort to reduce the necessity for field reviews of low-valued new construction, the assessor uses a self-reporting program to establish a new base value for certain forms of new construction. For all building permits valued at \$150,000 or less that are determined to represent new construction, the assessor sends a building permit statement letter to the property owner. The statement gives the property owner an opportunity to provide a diagram of the new construction and answer basic questions regarding the building permit (e.g., type of construction, project status, cost of construction, and description of construction). If the statement is not returned, the assessor will either send a second request or field review the new construction.

New Construction Valuation

The Santa Clara County Assessor uses several cost sources, including unit cost factors published in Assessors' Handbook Section 531, *Residential Building Costs* (AH 531), owner's actual cost, *Marshall Valuation Service* published cost guide, or locally developed market costs for rural and residential properties. The value of new construction of commercial, industrial, and special use properties is estimated using the sales comparison approach, income approach, actual cost, or *Marshall Valuation Service*.

RECOMMENDATION 10: Apply an appropriate depreciation allowance to the value of newly constructed additions to existing improvements.

The assessor improperly values newly constructed additions to older buildings at 100 percent of replacement cost new (RCN) when using the replacement cost approach to value.

In order to make an accurate cost estimate of an addition, the assessor must reflect its impact on the existing improvements. In many instances, construction of an addition includes modern design techniques and modern building materials superior to those found in the existing structure. In such cases, the physical or functional obsolescence of the older improvement may cause the value of the addition to be less than the cost to construct it. At the same time, the older improvement may experience an increase in value due to the modern nature of the addition.

We recommend that the assessor apply depreciation allowances where appropriate to new construction added to existing improvements

Supplemental Assessments

Sections 75 et seq. require the assessor to appraise property at its full cash value on the date the property changed ownership or upon completion of new construction and issue a supplemental assessment. The increase or decrease in assessed value (supplemental assessment) resulting from a change in ownership or new construction is reflected in a prorated tax bill that covers the portion of the fiscal year remaining after the date of change in ownership or new construction.

We reviewed the assessor's procedures for supplemental assessment procedures as applied to a variety of property types. We found only one problem area (i.e., the application of the inflation factor for changes in ownership of manufactured homes that occur between January 1 and June 30). This issue is discussed in this report under the topic of Manufactured Homes.

Decline in Value

Section 51(a) requires the assessor to enroll the lesser of either a property's factored base year value or its full cash value, as defined in section 110. When a property's current market value falls below its factored base year value on any given lien date, the assessor must enroll that lower value as the taxable value for that property. If, on a subsequent lien date, a property's value rises above the factored base year value, then the assessor must enroll the factored base year value as the taxable value.

Between 1995 and 2001, the number of properties under review for a decline in value decreased from 98,196 to approximately 300. In response to recent changes in market conditions, the assessor has reduced the assessments of 29,014 parcels on the 2002-03 secured roll, representing approximately 5.4 percent of all properties assessed.

Discovery

The assessor uses a variety of methods to identify properties that may have market values less than their factored base year values (e.g., newspaper articles and taxpayer reporting). However, the assessor depends primarily upon the expertise of his appraisal staff and their knowledge of activity in the market. Market data is compiled and monitored by geographical area, property type, and date of transfer. When a general trend of declining values is documented, the assessor will make the appropriate adjustments to the roll value.

When an assessment that is lower than the factored base year value is increased, the assessor mails an assessment notification card to the property owner. The notice includes a statement that the taxpayer may request a review of the assessed value if they believe the value is incorrect. All requests for review are documented and routed to the appropriate appraiser.

To identify properties that declined in value for the 2002 lien date, the assessor targeted commercial, industrial, and multifamily properties. In addition, the assessor reviewed all transfers of single-family residences and condominiums recorded through February 2002. Sales

and pricing levels for the preceding two years were analyzed to establish monthly adjustment factors within individual school district boundaries.

The assessor developed an automatic reduction program using statistical analysis to reflect current market values as of the January 1, 2002 lien date. The assessor applied this automated mass adjustment process to all districts in the county except Gilroy, where property values were individually reviewed for possible decline-in-value adjustments.

The assessor makes a proactive effort to identify properties that have declined in value.

Documentation

We found that files for properties subject to decline-in-value reviews contained adequate documentation. The assessor requires that commercial and industrial property files and multifamily property files include a replacement cost approach, income approach, or sales comparison approach to support the appraiser's opinion that the current assessed value is less than the factored base value.

The assessor's decline-in-value program is well organized and effective. The assessor adheres to statutory provisions governing the assessment of properties that have experienced declines in value.

California Land Conservation Act Property

Agricultural preserves may be established by a city or county pursuant to the California Land Conservation Act (CLCA) of 1965 for the purpose of determining boundaries of areas in which the city or county is willing to enter into contracts with property owners. Property owners in an agricultural preserve who choose to enter into a contract agree to restrict the use of their lands for agriculture and compatible uses in exchange for assessment at a restricted value. Lands under such contracts are valued for property tax purposes by a methodology based upon agricultural income-producing ability, including income derived from compatible uses (e.g., hunting rights and communications facilities). They are assessed at the lowest of the restricted value, the current market value, or the factored base year value. Sections 421 through 430.5 govern the assessment of land subject to agricultural preserve contracts. Assessors' Handbook Section 521, *Assessment of Agricultural and Open-Space Properties* (AH 521), provides informal guidance for the appraisal of these properties.

For the 2002-03 roll, Santa Clara County had 3,920 parcels comprising 352,563 acres under CLCA contract, of which 9,379 acres are in "nonrenewal" status. The total assessed value for land and living improvements is \$191,865,999, or 0.091 percent of the gross secured and unsecured 2002-03 roll value of \$210,179,547,510 (excluding the state-assessed roll value).

The valuation of CLCA properties is the responsibility of one real property appraiser. To ensure assessment uniformity, one appraiser is responsible for valuing all living improvements on all CLCA lands. Assessed values for CLCA properties are calculated by a computer program that uses a formula where the variables are the capitalization rates and net income estimates. The program calculates the section 423 restricted value and compares it with the factored base year

value. In general, land values in Santa Clara County have appreciated at a rate greater than 2 percent. Therefore, market value is rarely the lower value indicator.

Most of the rural property in Santa Clara County consists of grazing lands, vegetable cropland (e.g., garlic, lettuce, peppers, corn, alfalfa, barley, grain hay, and wheat), and nursery crops (e.g., bedding plants and ornamental trees), with the bulk of the revenue production from nursery and vegetable crops. However, there are also some orchards and vineyards.

In the summer of 2000, the assessor initiated a discovery program to identify existing orchards and vineyards. The program consisted of a field canvass, followed by questionnaires soliciting information about trees, vines, and associated improvements. The survey indicated the existence of more than 3,600 acres of orchards and more than 5,900 acres of vineyards in Santa Clara County.

To date, all the vineyards identified have been physically inspected and assessed. However, from information obtained about orchards, the assessor concluded that trees contribute no value to the total orchard property unit. Therefore, trees are not currently assessed in Santa Clara County.

Valuation of CLCA Property

Section 423(a)(1) requires the assessor, when valuing CLCA property, to capitalize an annual income determined from market rents, imputed to the land being valued, based upon rent actually received and typical rentals received in the area for similar land in similar use when sufficient rental information is available.

The assessor estimates production and expense for CLCA properties based on information obtained from CLCA questionnaires, the county's agricultural crop report, the grape crush report, and information gathered from surrounding counties. The CLCA questionnaires are mailed annually, with an estimated response rate of 35 to 40 percent.

In our prior survey report, we repeated a recommendation that was originally made in 1989 that the assessor use animal unit months (AUM's) as the unit of measurement in assessing grazing land. AUM's are an effective unit of comparison that can be used in the valuation of grazing land. The Santa Clara County Assessor considers multiple units of comparison, including AUM's, but values grazing land by capitalizing the economic net rent into an indication of value. Rent per acre is another recognized and accepted unit of comparison. In our review, we found no indication that the assessor's method of valuing grazing land results in erroneous assessments. Therefore, we are not repeating this recommendation.

RECOMMENDATION 11: Deduct a capital replacement allowance for irrigation wells that contribute to the income being capitalized.

The assessor does not allow for a return of the investment in irrigation wells as an expense to be deducted from gross income to land, as required by section 423. The return of the well cost is erroneously included in the restricted value calculation for land.

AH 521 provides that the appraiser should deduct a charge for a return on and of the value of improvements from the income stream prior to capitalizing the market income into value. Wells

are classified as land for property tax purposes and return on investment is included in the land capitalization rate. However, they are a wasting asset, and an allowance for capital replacement must be allowed for in the capitalization of the income stream. The assessor's policy could result in the over or under assessment of wells on CLCA restricted land.

We repeat our recommendation that the assessor deduct a capital replacement allowance to allow for a return of the investment in irrigation wells that contribute to the income being capitalized.

RECOMMENDATION 12: Establish base year values for CLCA property.

We found the assessor has not established base year values for many of the CLCA properties in Santa Clara County. The assessor continues his efforts to track the base year values of properties under CLCA contract in an electronic format. Currently 1,253 parcels out of a total 3,920 parcels do not have a factored base year value in the computer system.

Without factored base year values, the assessor cannot make the three-way comparison required by section 423(d). This section requires the assessor to enroll the lowest of restricted, current market, or factored base year value. Whether the factored base year value is currently tracked in the electronic format or still remains only in the physical property records, the assessor always verifies the base year value before establishing the recaluculation of non-renewal values.

We recommend the assessor track base year values for all CLCA properties.

RECOMMENDATION 13: Properly calculate the income charge to nonliving improvements.

The assessor incorrectly uses the risk rate instead of the property tax rate to calculate the charge for nonliving improvements.

According to AH 521, the correct rate components to use in determining a charge for nonliving improvements include the market yield rate and the estimated property tax rate. The assessor's computerized CLCA program uses the risk rate component instead of the tax rate component to arrive at a capitalization factor. The risk rate of two percent (used for properties with living improvements) is higher than the property tax rate of one percent. The assessor's current practice results in lower assessed values than would be determined under the guidelines recommended in AH 521.

We recommend that the assessor properly calculate the income charge to nonliving improvements.

Taxable Government-Owned Property

Article XIII, section 3 of the California Constitution exempts from property taxation property owned by local governments, except as provided in section 11, which provides that land, and the improvements thereon, located outside a local government agency's boundaries are taxable if the property was taxable at the time of acquisition. Improvements that were constructed to replace improvements that were taxable when acquired are also taxable. These lands and taxable improvements are commonly referred to as *Section 11* properties.

For the 2001-02 fiscal year, the assessor enrolled 143 Section 11 properties with a total assessed value of \$15,874,457. Included in these properties are 122 parcels that are part of the Hetch Hetchy water project with assessments totaling \$11,022,541.

One supervising real property appraiser is responsible for discovering and valuing all taxable government-owned properties. This appraiser uses spreadsheets to annually review each property's factored base year value and restricted (Phillips factor) value, then enrolls the lower of the two values.

In past years, the assessor estimated the market value of all Section 11 properties and found that in every instance the market values far exceeded both the factored base year values and the restricted values. As a result, the assessor no longer estimates current market value for these properties.

RECOMMENDATION 14: Enroll the lesser of current market value or restricted value as the base year value of taxable government-owned land.

Following a government agency's acquisition of a taxable property, the assessor enrolls the current market value as the base year value, without considering the restricted value as of the date of sale.

The BOE's Letter To Assessors (LTA) No. 2000/037, *Guidelines for the Assessment of Taxable Government-Owned Properties*, states: "Base year values for taxable government-owned properties acquired after March 1, 1975, are established at the lower of current fair market value as of the date of change in ownership, or the 1967 assessed value multiplied by the appropriate Phillips Factor as of the date of change in ownership."

As a result of failing to consider the restricted value in establishing base year values for Section 11 properties, the assessor has established incorrect base year values. Because of these errors, in several instances, the staff enrolled a restricted value for 2001-02 that exceeded the appropriate factored base year value.

We recommend that the assessor enroll the lower of the current market value or restricted value when establishing new base values for Section 11 properties.

Timberland Production Zone Property

Land zoned as a Timberland Production Zone (TPZ) is assessed in accordance with special TPZ site classifications that exclude the value of the standing timber. The assessed value of TPZ land each year must be its appropriate site value added to the current market value of any existing compatible nonexclusive uses of land. This treatment does not apply to structures on TPZ lands or to the sites that accommodate such structures. Instead, structures and their supporting lands are subject to the same assessment treatment as other real property. Land zoned as TPZ that is not under a California Land Conservation Act contract is assessed at the lowest of its appropriate site value, current market value, or factored base year value.

Santa Clara County has five TPZ parcels comprising 148,695 acres. The total assessed value for 2002-03 was nearly \$165,000. All TPZ parcels are forested with pine-mixed conifer trees.

The assessor field reviews TPZ properties approximately every four years to discover changes, and to accurately identify and value TPZ land. All TPZ properties are properly assessed.

Possessory Interests

A taxable possessory interest results from the possession, or a right to possession, of publicly owned real property, where the possession provides a private benefit to the possessor and is independent, durable, and exclusive of rights held by others. The assessment of a taxable possessory interest is based on the value of the rights actually held by the possessor; the rights retained by the public owner are not taxable.

Discovery

The Santa Clara County Assessor's program for discovering possessory interests includes an annual polling of all government entities in the county requesting information on land use agreements with private parties. The assessor annually contacts approximately 96 public agencies by letter or in person to request current information on all uses of their property. There are currently 2,489 taxable possessory interests assessed in Santa Clara County with a total value exceeding \$801 million.

The majority of possessory interest appraisals are assessed on the unsecured roll and are processed by one senior appraiser. Possessory interests in the San Jose Redevelopment District are assessed on the secured roll by three appraisers responsible for appraising hotels, high-rise office buildings, and special use properties. The total assessed value of all possessory interests represents approximately 0.35 percent of the assessment roll value for year 2002-03.

RECOMMENDATION 15: Reappraise month-to-month possessory interests only at the expiration of the anticipated term of possession as provided in section 61(b)(2).

The assessor incorrectly reappraises month-to-month tenancies annually, typically using an anticipated term of possession of three to eight years. When values remain constant or decline from the previous year, an annual revaluation is appropriate. However, in many situations, the assessor has entered a value that is greater than the adjusted base value.

Section 61(b) provides that the creation, renewal, extension, or assignment of a taxable possessory interest is a change in ownership for property tax purposes. However, section 61(b)(2) provides that the renewal or extension of a taxable possessory interest during the reasonably anticipated term of possession used by the assessor to value the interest does not result in a change in ownership until the end of that reasonably anticipated term of possession. Thus, if a taxable possessory interest is originally valued using a reasonably anticipated term of possession of five years, that interest should not be reappraised until the expiration of the five-year term originally used to value the interest, assuming there is no intervening change in ownership.

The assessor's practice is contrary to statutory provisions and overvalues those possessory interests. We recommend that the assessor reappraise taxable possessory interests only at the end

of the anticipated term of possession, as required by section 61(b)(2) or to recognize decline in value as required in section 51(a)(2).

Historical Property

Government Code section 50280 provides that an owner of a qualified historical property may enter into a contract with a local government restricting the use of that property in exchange for a statutorily prescribed assessment treatment. Section 50280.1 provides that in order for a property to qualify for assessment as a historical property it must, among other requirements, be listed on the National Register of Historic Places or be listed on a state, county, or city register as historically or architecturally significant.

Historical properties are assessed annually at the lowest of the factored base year value, the current market value, or the restricted value. The restricted value must be determined by the income capitalization method set forth in section 439.2. In this method, a fair or market rent less "ordinary and necessary" expenses is capitalized at a rate that is not derived from the market. Rather, the rate is a summation of the four basic components as prescribed in section 439.2, subdivision (b), as follows:

- An interest component that is determined annually by the BOE;
- A risk component of 2 percent (4 percent if the property is owner-occupied);
- A component for property taxes; and
- A component for amortization of the improvements.

For the 2002-03 roll, the assessor enrolled 43 qualifying historical properties with a taxable value of \$11,012,913.

Most of the properties were owner-occupied residences; 24 of the 43 properties were located in the City of Santa Clara. There were no mixed-use properties. Four properties were added to this program during 2001, three properties added during 2002, and only one property is in nonrenewal status. We found no deficiencies in the documentation. Parcel records include a copy of the contract, property description, and an annual valuation report. The assessor annually enrolls properties of this classification at the lowest of their factored base year value, current market value, or restricted value. The county's valuation procedures are in compliance with sections 439 through 439.4.

Leasehold Improvements

Leasehold improvements are improvements or additions to leased property that have been made by the tenant or lessee. Such improvements can be secured to the real property or assessed to the lessee on the unsecured roll.

Commercial, industrial, and other types of income-producing properties require regular monitoring by the assessor because, as tenants change over time, they may add and remove

improvements that may result in a changed use of the property. These changes must, by law, be reflected in the property's assessment if they qualify as new construction.

When real property is reported on the business property statement, coordination between the assessor's real property and business property divisions is important. Both an appraiser in the real property division and an auditor-appraiser in the business property division should examine the reported cost. The divisions should determine the proper classification of the property to ensure appropriate assessment by each division and avoid escapes and double assessments. The assessor's office must determine whether costs are for repair and maintenance and are, therefore, not assessable, whether additions are properly classified as structural improvements or fixtures, and if additions are properly enrolled.

Schedule B of the BOE-prescribed *Business Property Statement* (Form BOE-571-L) is reserved for reporting costs incurred for structures, fixtures, land improvements, or land owned by the taxpayer. The assessor utilizes Schedule B as a valuable resource in discovering new tenant improvements.

Both the real property and business property divisions use the *Leasehold Improvements Referral Slip* (Form 8526), which is a three-part form requiring written follow-up, to coordinate the classification, assignment, and assessment responsibility for leasehold improvements. We reviewed the assessor's records for discovery, coordination, classification, and communication, and noted two areas for improvement.

RECOMMENDATION 16: Correctly classify and assess leasehold improvements.

This recommendation is repeated from the September 1998 Assessment Practices Survey and the more recent May 2001 Supplemental Assessment Practices Survey. We reviewed several accounts to determine if the above prior recommendation had been fully addressed and implemented. The problem persists.

The real property division typically assesses structure items and the business property division assesses those items that are reported as fixtures, without investigation into the nature of the items being assessed. We found that this practice has led to misclassification of structures and fixtures, which leads to erroneous assessments. For example, costs reported for work that did not constitute new construction (e.g., repair and maintenance of a building, or additions statutorily excluded from new construction, such as fire protection systems) were classified as fixtures and included in the business property assessment; and items that should have been classified as building improvements were assessed as fixtures or were assessed to both the landlord and the tenant. Not only did this result in inaccurate values, it also meant lost tax revenue for those items that, because they should have been classified as real property, would have been issued supplemental assessments.

The assessor has an established procedure in place for assessing leasehold improvements. However, it appears that the procedure is not always followed. We recommend that the assessor take steps to improve the coordination of leasehold improvement assessments.

RECOMMENDATION 17: Investigate all reported leasehold improvement costs.

This recommendation is also repeated from the September 1998 Assessment Practices Survey and the May 2001 Supplemental Assessment Practices Survey.

For purposes of determining assessability between the real property and business property divisions, the assessor has established guidelines regarding new structural improvement costs reported on Schedule B of the Form BOE-571-L. If the business property is secured to the real property, all new structural improvement costs, including structural construction-in progress, are referred to the real property division for determination of assessability. For unsecured accounts, various steps are taken before a determination of assessability is made. First, Schedule D, *Supplemental Schedule for Reporting Monthly Acquisitions and Disposals of Property Reported on Schedule B of the Business Property Statement*, is reviewed for detail of the new structural improvement costs. If the costs are for repair or maintenance, they are marked a "N/A", non-assessable. Then AIMS is reviewed for referral information from real property based on permit analysis. Time permitting, the taxpayer is contacted for further information. After all steps are undertaken, if no clear determination can be made and the costs are \$100,000 or more, a referral is made to real property. Typically, if insufficient detail is available for unsecured structures costing less than \$100,000, then the business division will assess, pending audit resolution. Without clear evidence that costs are incorrectly classified, all costs reported as fixtures will be assessed as such.

This practice treats taxpayers unequally, based on an arbitrary threshold, and can produce erroneous assessments when costs below \$100,000 are not investigated. We recommend that all reported costs be investigated to determine whether they represent new fixtures or new construction of real property.

Water Company Property

Water company property assessed on the local tax roll may include property owned by private water companies and mutual water companies. Portions of government-owned water systems may also be taxable. Each type presents a different assessment problem.

Mutual Water Companies

When mutual water company shares are appurtenant to the land, the value of the mutual water company property is typically reflected in the value of the property being served and to which the shares are attached. In such cases, we recommend a token value be assigned to mutual water company lands, improvements, and delivery systems in order to avoid double assessments.

A mutual water company is a private association created for the purpose of providing water at cost, to be used primarily by its stockholders or members. The association, when incorporated, can enter into contracts, incur obligations, own property, and issue stock. If not incorporated, it can only do these things in the name of its members. Corporations organized for mutual purposes are not subject to regulation by the California Public Utilities Commission (CPUC) unless they deliver water for compensation.

Santa Clara County has 23 small mutual water companies. We found that the assessor values mutual water company properties in a manner consistent with BOE's recommendations.

Private Water Companies Regulated by the California Public Utilities Commission

Regulated water companies are privately owned utilities in business to earn a profit from the sale of water. Regulated water companies are required to submit financial reports annually to the CPUC. The CPUC regulates the rates charged by private water companies, limiting profits to a return based on the companies' outstanding investment. Because the assessed values of these properties are tied directly to regulated rates, current market value may be less than a water company's factored base year value, making it necessary to periodically reappraise the company's property as of the lien date. The market value of regulated water company property is often close to the HCLD indicator when the income from the property is regulated by law and is based on the company's book cost less depreciation.

There are seven regulated water companies in Santa Clara County. A senior auditor-appraiser annually reviews the properties owned by these companies. The assessor continues to request information from water companies and annual reports from the CPUC. However, the information supplied by these sources is limited or unreliable. After reviewing the assessor's methodology and the values used in the assessment of the private water company properties, we have concluded that they are reasonable under the circumstances and based on accepted appraisal principles for valuing water company properties.

We encourage the assessor to continue his efforts regarding the review and valuation of regulated water company properties.

Pipeline Rights-of-Way

Intercounty pipeline rights-of-way were assessed by the BOE from approximately 1982 until 1993, when an appellate court ruled that such assessments were outside the BOE's constitutional authority.⁵ The court ruled that while the pipelines themselves are properly assessed by the BOE, the right-of-way through which the pipelines run must be locally assessed. Subsequent to this court ruling, the Legislature added sections 401.8 through 401.12, governing county assessors in the valuation of intercounty pipeline lands and rights-of-way.

The assessor has assigned a supervising appraiser to monitor and assess these rights-of-way, which are held by four companies in Santa Clara County. The total assessed value of these rights-of-way is \$9,238,818. A new set of assessor's parcel numbers and a computer spreadsheet were developed to implement the statutory changes. Each pipeline assessee is assigned a single countywide assessor's parcel number that reflects the total value of the rights-of-way owned.

When valuing the pipeline rights-of-way prior to the court decision, the BOE developed density classifications for appraisal purposes, and assessors have generally adopted this methodology. Should an assessor use different classifications or associated values, the assessor loses the benefit of a statutory presumption of correctness. Santa Clara County uses the three BOE's classifications: high density, transitory density, and low density. High density is valued at

⁵ *Southern Pacific Pipe Lines Inc. v. State Board of Equalization* (1993) 14 Cal.App.4th 42.

\$20,000 per mile, transitory density is valued at \$12,000 per mile, and low density is valued at \$9,000 per mile. There are no multiple pipelines in the same rights-of-way.

Pipeline rights-of-way in Santa Clara County are being valued in accordance with sections 401.8 through 401.12.

ASSESSMENT OF PERSONAL PROPERTY AND FIXTURES

The assessor's program for assessing personal property and fixtures includes the following major elements:

- Discovery and classification of taxable personal property and fixtures.
- Mailing and processing of annual property statements and questionnaires.
- Annual revaluation of taxable personal property and fixtures.
- Auditing taxpayers whose assessments are based on information provided in property statements.

Audit Program

A comprehensive audit program is essential to the successful administration of any tax program that relies on information supplied by taxpayers. A good audit program discourages deliberate underreporting, helps educate those property owners who unintentionally misreport, and provides the assessor with additional information to make fair and accurate assessments.

Mandatory Audits

Pursuant to section 469, audits are mandatory for taxpayers reporting business tangible personal property and trade fixtures valued at \$400,000 or more. The Santa Clara County Assessor's mandatory audit workload for the last four years is as follows:

YEAR	NUMBER OF AUDITS
2002	1,085
2001	931
2000	1,034
1999	1,120

The county has currently completed all but 16 scheduled audits. Of these, eight have been assigned to the California Counties Cooperative Audit Exchange Program and not yet been completed. The others are either accounts that were discovered and enrolled late or are still within the four-year statute of limitations for audits. The assessor appears to exercise proper management over his audit workload.

Nonmandatory Audits

A nonmandatory audit program serves several purposes in the assessment of personal property. Besides helping to mitigate taxpayer reporting errors, a nonmandatory program also allows for

the investigation and resolution of special problems uncovered during the processing of property statements.

The assessor has an active nonmandatory audit program. In 2001, he completed 161 nonmandatory audits.

Statute of Limitations

Section 532 requires that the assessor enroll an escape assessment discovered during an audit within four years after July 1 of the assessment year during which the property escaped assessment. If the assessor cannot complete an audit within the prescribed time, the assessor may request, pursuant to section 532.1, a waiver of the statute of limitations from the taxpayer to extend the time for making an assessment.

The assessor has consistently requested taxpayers to sign a waiver of the statute of limitations when an audit cannot be completed timely.

Audit Quality

An audit should follow a standard format so that the auditor-appraiser may easily determine whether the property owner has correctly reported all taxable property. Audit narratives and summaries should include adequate documentation, full value calculations, and reconciliation of the fixed assets totals to the general ledger and financial statements. It should also include a review of asset invoices, reconciliation between reported and audit amounts, an analysis of expense accounts, and an analysis of depreciation and obsolescence factors that may affect the business property.

The assessor has developed a computerized audit program and several checklists that are tailored for various industries. In addition to the audits we reviewed as part of the assessment sampling program, we reviewed six additional audits performed by the assessor and concluded that the assessor's audit program is well administered.

Business Property Statement Program

Section 441 requires each person owning taxable personal property (other than manufactured homes) having an aggregate cost of \$100,000 or more to annually file a business property statement with the assessor; any other person must file a property statement if requested by the assessor. Property statements cover a wide variety of property types, including commercial, industrial, and agricultural properties, as well as boats and certificated aircraft. The assessor's procedures manual for processing property statements includes hundreds of pages, and was last updated in March 2002.

For the 2002-03 assessment year, the Santa Clara County Assessor's business property division processed 98,027 property statements with a net taxable value of more than \$30 billion. These property statements include regular business accounts (e.g., semiconductor manufacturers, computer manufacturing companies, electronic manufacturing companies, wholesalers, and retailers), banks and insurance companies, and insufficient-to-assess (ITA) accounts. ITA's are businesses that the assessor requested the filing of a business property statement, but the reported

costs were considered insufficient to process. Also included in the total taxable value are marine and aircraft accounts.

A new feature in the assessor's method of costing items of personal property, the "Cost Capture" program, has been installed in the assessor's computer system and the procedures to operate the program have been added to the updated policies and procedures manual. In addition to its ability to automatically calculate depreciated replacement cost new based on original reported cost, the program also incorporates an automatic look-up feature. This feature allows the data entry staff to look into an account's history and retrieve from the database the business class code. Once the business class code is identified, the program assigns the appropriate factor tables relating to the reported costs of machinery, equipment, and fixture.

The enhanced "Cost Capture" program calculates the property's value so that it allows the clerical staff to process routine property statements, subject to oversight by a certified auditor-appraiser, freeing the auditor-appraisers to work the more complex business accounts. The assessor implemented our prior recommendations that the property statements be reviewed for authorized signatures and that old data be purged from the business property files.

The assessor introduced e-filing of property statements on a limited scale beginning with the 2002 lien date, but it is expected to be widely implemented starting with the 2003 lien date. The e-filing program is a further refinement of the assessor's 1998 launching of a system that allows taxpayers to file their property statements using computer data storage disks.

Leased Equipment

The business property division is responsible for the discovery, valuation, and assessment of leased equipment. This type of property is one of the more difficult types of property to assess correctly. Common problems include difficulty in establishing taxability and taxable situs, reporting errors by the lessees or lessors, valuation (whether the value of the equipment should be the lessor's cost or the cost for the consumer to purchase), and double or escape assessments resulting from lessor and lessee reporting. These issues are discussed in detail in Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures*.

RECOMMENDATION 18: Ensure that all equipment is properly assessed upon termination of lease.

We reviewed eight lessors' property statements for the 2001 and 2002 lien dates. In situations in which the lease for equipment terminated, we found no indication that the assessor reviewed the lessees' property statements or contacted the lessors to determine the status and ownership of the equipment. Only in the case of the larger leasing companies does the assessor investigate the ownership and taxability of equipment going off-lease.

Without knowing the date and duration of the leases, the assessor cannot determine if these are new leases or if the equipment escaped assessment in previous years. Obtaining detailed information pertaining to leased equipment is important in determining the proper assessee and trade level, and for tracking leased equipment from year-to-year. We recommend that the assessor determine the proper assessee for all equipment upon the termination of lease.

Direct Billing

Many California assessors utilize an assessment procedure called "direct billing" or "direct assessment." It is a method of assessing certain smaller business accounts without requiring the annual filing of a business property statement. An initial value is established and continued for several years, with only periodic property statements or field reviews. Examples of businesses suitable for direct billing include apartments, barber shops, beauty parlors, coin-operated laundrettes, small cafes, restaurants, and professional firms with small equipment holdings.

The direct billing program is beneficial to both taxpayers and the assessor. Direct billing streamlines filing requirements, reduces the amount of paperwork for small businesses, and reduces the number of property statements that must be processed by the assessor.

Accounts appropriate for direct billing are usually established businesses having tangible personal property costing less than \$100,000 and only minor changes in equipment holdings from year to year. Small barbershops and small retail stores with minimal equipment holdings are good examples. The total personal property and fixture value of these businesses usually changes little from year to year.

In Santa Clara County, there were 682 direct billing accounts on the 2002-03 assessment roll. This number represents less than 1 percent of the more than 98,000 business property accounts processed and enrolled for the 2002-03 fiscal year. The assessor's direct billing program applies only to apartment houses of fewer than 50 units where the taxpayer has a two-year history of accurately filing a business property statement.

RECOMMENDATION 19: Include only accounts with a cost of less than \$100,000 in the direct billing program.

We found ten direct billed accounts in which the total cost of personal property owned by the taxpayer exceeded \$100,000. One had a 2002-03 full value of more than \$1 million. In two other accounts, the assessment included personal property in multiple locations, but the total cost of all of the property exceeded \$100,000. Eight of the accounts had a value range between \$100,400 and \$1,101,146.

Section 441 provides that each person owning taxable personal property, other than a manufactured home, having an aggregate cost of \$100,000 or more to file a property statement with the assessor. Since the law expressly requires the filing of property statements for such accounts, the assessor should not include them in the direct billing program.

Biopharmaceutical Equipment

RECOMMENDATION 20: Properly classify and consistently assess biopharmaceutical industry equipment.

The assessor's biopharmaceutical accounts showed misclassification of equipment and inconsistencies in valuation. One account was designated as "Industrial and Business Services," with a commercial service life of 12 years. A second account was classified as "Scientific

Equipment and X-Ray," with an industrial service life of 12 years. Another was classified as "Miscellaneous Unclassified Products," with an industrial service life of eight years. Finally, one was classified as "Drugs, Cosmetics, Soap, Sundries," with an industrial service life of eight years.

In each case, the companies' equipment was valued using commercial and industrial valuation factors found in the Assessors' Handbook Section 581, *Equipment Index and Percent Good Factors*. For biopharmaceutical industry equipment and fixtures, the assessor should use the special factor table adopted by the BOE in 1999, which is included in AH 581.

We recommend that the assessor properly classify and assess biopharmaceutical equipment.

Business Equipment Valuation

RECOMMENDATION 21: Make estimated assessments based upon available information, as required by section 501.

The assessor's business property division estimates the value of both real and personal property owned by assesseees who fail to file property statements. The estimates are made by increasing the prior year's assessed value, less any penalty from the prior year, by 10 percent. Pursuant to section 463, a 10 percent penalty is then added to the current year's enrolled value. The same procedure is followed in subsequent years. This technique may be used to recognize economic growth and to persuade the taxpayer into complying with the reporting requirements. However, the current policy may lead to inaccurate assessments resulting in large refunds upon audit.

Section 501 provides that "if after written request by the assessor, any person fails to comply with any provision of law for furnishing information required by sections 441 and 470, the assessor, based upon information in his possession, shall estimate the value of the property and, based upon this estimate, promptly assess the property."

When the property is a combination of personal property, land, and structures, the assessor's policy is in conflict with article XIII A of the California Constitution. The assessor's estimate involving land and structures should not be increased by more than 2 percent each year unless new construction or a change in ownership has occurred, or unless the property was in a decline-in-value status in prior years and has been restored to its factored base year value. The assessor may increase the prior year's assessment of the personal property by 10 percent for growth; however, for land and structures, increases should be limited to the BOE-announced inflation factor. Except as noted above, any further increase is in conflict with article XIII A.

We recommend that the assessor make assessments under section 501 based upon available information, and value both personal property and real property appropriately.

Apartments

RECOMMENDATION 22: Properly assess personal property in apartments.

We noted that the assessor continues to use a fixed amount per living unit to value apartment personal property instead of relying on costs reported in property statements.

If the property statement indicates original costs, those costs are used for valuation of the personal property. However, if the calculated full cash value is less than \$100 per unit, the assessor instead assigns a fixed amount of \$300 per furnished unit, \$150 per partially furnished unit, \$250 per refrigerator, and \$300 per every 10 units for laundry equipment. He also assesses additional amounts, ranging from \$1,000 to \$5,000, in larger apartment complexes that have swimming pool equipment, pool furniture, exercise, office, and maintenance equipment.

Information supplied on Form BOE-576-R, *Apartment House Property Statement*, should be the starting point for the assessment of apartment personal property. Because the historical information on the property statement will reflect variations in the age, quality, and quantity of personal property from one apartment property to the next, using this information should lead to an accurate valuation of apartment personal property.

We repeat our recommendation that the assessor base his assessment of apartment personal property on information submitted on the business property statements.

Minimum Valuation Factors

RECOMMENDATION 23: Use Assessors' Handbook Section 581 as intended.

The assessor has adopted the equipment value factors developed by the California Assessors' Association (CAA). The CAA tables employed by the assessor use the BOE's AH 581 percent good factors, except that they employ arbitrary minimum valuation factors for older equipment. The assessor currently uses a minimum percent good factor for agricultural, commercial, construction, and industrial equipment. This means that very old equipment is valued as though it has several years of profitable service left. This practice deviates from the tables contained in AH 581 and results in over valuation of older equipment. As part of our 2001-02 assessment roll sampling, we reviewed assessments of 10 properties that included machinery and equipment. Our valuations of the machinery and equipment were lower than the assessor's value in every case.

The percent good factors in the BOE's AH 581 are based on the assumption that, as business equipment ages, it gradually loses its ability to earn a profit for its owner. In some cases equipment wears out physically to the point where it is not cost-effective to repair it. In other cases, the equipment may be in excellent condition physically, but new technology, a changing market relative to the type of equipment, and other external factors make the equipment obsolete.

Some equipment, when no longer cost-effective to operate, will have a salvage value, whereas other equipment will have a negative value that stems from the cost of disposal. The AH 581 factors assume that, on the average, equipment will have a zero value when retired. For

commercial and industrial equipment, the factors decline from 100 percent good when acquired to one percent good (99 percent depreciation) for equipment that has survived long past the average service life of similar equipment but is still in use.

There is no question that some older equipment is worth much more than 1 percent of replacement cost new, just as some newer equipment is worth substantially less than the percent good suggested by the AH 581. When making appraisals of individual items of equipment, the assessor may use sales data, income data, or any other available evidence to find fair market value.

However, when using a mass appraisal tool such as the AH 581 tables, it is important to use the tables as presented. Use of arbitrary minimum valuation factors may value some equipment correctly, but will substantially overvalue most items of older equipment. Accordingly, we recommend the assessor use the AH 581 as intended in order to avoid overvaluations.

Computers

In order to promote uniformity in appraisal practices and assessed values, and to comply with the requirements of section 401.5, the BOE has issued valuation factors for computer equipment. In the AH 581, Table 6: Computer Valuation Factors, the BOE provides valuation factors for use when valuing computer equipment.

For lien date 2002, AH 581 contains tables for three categories of computer equipment: small computers (costing \$25,000 or less), mid-range computers (with a cost range of \$25,001 to \$500,000), and mainframe computers (with costs of \$500,001 or more). The assessor values non-production computers using the BOE-recommended factors.

In our prior survey we recommended that the assessor revise the procedures for assessing computer programs by assessing only basic operational programs. We found that the assessor does assess computer software when the programs are embedded within the computer system itself. If computer hardware is reported separately from the purchase price of the hardware, the assessor does not assess the software until it can be verified through an audit whether the software is a basic operational program or if it is an application program.

Aircraft

General Aircraft

The Santa Clara County Assessor values approximately 1,000 aircraft per year. One auditor-appraiser and one appraisal technician are responsible for the assessment of all airplanes within the county. The assessor discovers and tracks aircraft through the airport manager's hangar reports, referrals from other counties, Federal Aviation Administration reports, and physical inspections.

Section 5363 requires the assessor to determine the market value of aircraft according to standards and guidelines prescribed by the BOE. Section 5364 requires the BOE to establish such standards to be used by the assessor. On January 10, 1997, the BOE approved the *Aircraft*

Bluebook-Price Digest (Bluebook) as the primary guide for valuing aircraft, with the *Vref Aircraft Value Reference* as an alternate for aircraft not listed in the *Bluebook*.

The assessor values aircraft based on the *Aircraft BlueBook-Price Digest* with appropriate adjustments for variances in aircraft engine hours, overall condition, aircraft navigational equipment, and avionics.

When actual aircraft costs are available, the assessor compares the owner's cost with the indicated values from the bluebook and enrolls the owner's cost only when it is sufficiently documented.

Certificated Aircraft

Certificated aircraft are aircraft operated by air carriers and air taxis in scheduled air taxi operations. Unlike general aircraft, which are normally assessed 100 percent at the place where they are habitually located as of the January 1 lien date, assessments of certificated aircraft are allocated among taxing jurisdictions based upon ground and flight time and arrivals and departures during a representative period designated by the BOE. Certificated aircraft are valued pursuant to the methodologies described in section 401.15.

The assessor assesses certificated aircraft owned by approximately 20 airlines. We reviewed the assessments of certificated aircraft for two airline companies and noted that the recommended methodologies are applied properly.

Historical Aircraft

Aircraft of historical significance are exempt from taxation upon meeting certain requirements. Section 220.5 defines "aircraft of historical significance" as any aircraft which is an original, restored, or replica of a heavier than air powered aircraft which is 35 years or older or any aircraft of a type or model of which there are fewer than five in number known to exist worldwide.

The historical aircraft exemption is not automatic. The owner of a historical aircraft must submit an affidavit on or before 5:00 p.m., February 15, and pay a filing fee of thirty-five dollars (\$35) upon the initial application for exemption. Along with these requirements, aircraft of historical significance are exempt only if the following conditions are met: (1) the assessee is an individual owner who does not hold the aircraft primarily for purposes of sale; (2) the assessee does not use the aircraft for commercial purposes or general transportation; and, (3) the aircraft was available for display to the public at least 12 days during the 12-month period immediately preceding the lien date for the year for which exemption is claimed.

The assessor granted 64 historical aircraft exemptions for the 2002-03 assessment roll. All exemptions granted appear to be proper, with proper signatures and notary marks where applicable, and adequate documentation of the required display days.

Vessels

The assessor assesses about 4,700 vessels each year, with a total assessed value of \$64.3 million for the 2002-03 assessment roll. The primary discovery sources are Department of Motor Vehicle (DMV) reports, marina lists, and referrals from other counties.

RECOMMENDATION 24: Appraise vessels at market value.

The assessor establishes the original assessment of vessels at market value, determined by either the taxpayer's reported sales price or the *BUC Used Boat Price Guide (BUC)*. In subsequent years, the assessed value is determined by applying a 5 percent depreciation factor to the previous year's assessed value. When the depreciated value falls below \$5,000, the vessel becomes exempt as authorized by the county's low-value property exemption resolution.

There is no support for the annual 5 percent depreciation factor. Instead, this fixed depreciation factor serves to substitute administrative convenience for actual market value appraisals. While the assessor's boat valuation procedures are efficient overall, it is likely that the fixed depreciation rate seldom reflects actual vessel depreciation.

While staff limitations preclude the reappraisal of each vessel on an annual basis, we recommend that the assessor adopt a valuation approach that better reflects market value. One feasible method would be to select sample vessels from "new" and "used" groups of five classes each (sailboat, inboard, outboard, inboard-outboard, and personal watercraft). Trends in market values for these groups and classes could be determined by comparing published boat valuation guides for the current and previous years. The assessor could concentrate on doing this analysis on one class group per year. Once trend factors are computed, they should be applied to all vessels within that group.

We recommend that the assessor appraise vessels at market value.

Manufactured Homes

A manufactured home is subject to local property taxation if first sold new on or after July 1, 1980, or if the owner has requested conversion from vehicle license fee status to local property taxation. A manufactured home is defined in Health and Safety Code sections 18007 and 18008, and statutes governing the valuation and assessment of manufactured homes are contained in Revenue and Taxation Code sections 5800 through 5842. Most manufactured homes are classified as personal property and enrolled on the secured roll. If the home is situated on an approved permanent foundation system that meets the requirements of Health and Safety Code section 18551, it is assessed as real property.

One appraiser in the business property division is responsible for valuing all manufactured homes located in rental parks. Appraisers in the real property division are responsible for valuing manufactured homes situated outside of the manufactured home parks. As required by section 5830, all manufactured homes are assessed on the secured roll.

The number of manufactured homes located in rental parks and their total enrolled value for the last four years are as follows:

FISCAL YEAR	NUMBER ENROLLED	TOTAL ENROLLED VALUE
2002-03	8,910	\$477,550,418
2001-02	8,557	\$428,866,732
2000-02	7,788	\$350,083,004
1999-00	7,322	\$291,263,006

When a manufactured home in a park sells, the assessor values the home using the BOE's unit cost factors for manufactured homes. In subsequent years, the assessor factors the base year value for inflation if he believes the value increase is justified.

RECOMMENDATION 25: Use the Board of Equalization's manufactured home unit cost tables as intended.

For the 2001-02 fiscal year, the assessor performed a study to determine if it was proper to apply the BOE-announced article XIII A inflation factor to the assessed values of manufactured homes in rental parks. The analysis consisted of calculating the average increase from lien date 2000 to lien date 2001 of the replacement cost new less depreciation (RCNLD) for all manufactured homes. The percentage of increase in RCNLD was compared to the BOE's announced inflation factor in order to determine the annual adjustment for manufactured homes.

For analysis, the assessor developed a chart based on Assessors' Handbook Section 531.35 (unit cost factors for manufactured homes) that divided manufactured homes into 121 categories (11 quality classes for 11 ranges of living area) based on quality of construction and square footage. By comparing the annual change in replacement cost new for each category from lien date 2000 to lien date 2001, the assessor concluded that the average manufactured home with typical accessories increased in cost by 5.2 percent. To determine the annual depreciation, the assessor used the 25-year depreciation table from the AH 531. Based on the table's indicated depreciation, a home typically depreciated 54 percent over the first 25 years, or 2.2 percent per year. Based on an annual 5.2 percent average cost increase and 2.2 percent depreciation, the assessor estimated that manufactured homes had a net increase in value of 3 percent. Since the 3 percent increase exceeded the BOE's 2 percent inflation factor for 2001, the assessor applied the BOE's inflation factor to the enrolled values of all manufactured homes in parks.

While the assessor's method for calculating changes in the market values of manufactured homes is expedient, it does not take into account the wide differences in cost increases for homes of different qualities and sizes, or variations in the rates manufactured homes depreciate at different stages in their economic lives. We reviewed the chart the assessor prepared that showed the annual percentage increase in cost per square foot for homes of various quality and square footage. While the average unweighted increase in square foot costs for all categories was 6 percent, which the assessor applied in his analysis, approximately 40 percent of the quality-size categories experienced annual cost increases of 10 percent and another 40 percent of the categories increased by only 2 percent.

Similarly, the assessor's application of a uniform 2.2 percent depreciation factor does not reflect variations among different classes of manufactured homes. The AH 531 depreciation table indicates that depreciation does not occur at the same annual rate over the life of a manufactured home. For example, during years 3 through 11 annual depreciation ranges from 3 percent to 5 percent per year, a significant difference from the 2.2 percent the assessor applied to all homes regardless of age.

Oversimplifying the cost approach to estimate changes in market values results in the erroneous application of the inflation index to a substantial number of manufactured home assessments. Many homes whose replacement cost increased by only 2 percent for fiscal 2001-02, and were at an age where they were depreciating at a rate greater than 2 percent per year, should have had their values lowered for 2001-02 rather than increased by the inflation factor.

The assessor's current method of estimating changes in the market value is expedient but inaccurate. We recommend that the assessor use the BOE cost tables as intended to recognize individual differences in manufactured home replacement cost estimates.

RECOMMENDATION 26: Apply the inflation factor as required by section 75.18 for changes in ownership of manufactured homes that occur between January 1 and June 30.

The assessor does not apply the inflation factor to changes in ownership of manufactured homes that occur between January 1 and June 30, as required by section 75.18.

Section 75.18 provides that if a change in ownership occurs between January 1 and June 30, the new base year value shall be adjusted by the inflation factor on the January 1 following the change in ownership. The assessor's misapplication of the annual inflation factor may result in underassessment of some manufactured homes in subsequent years.

We recommend that the assessor apply the inflation factor for changes in ownership that occur between January 1 and June 30, as required by section 75.18.

RECOMMENDATION 27: Enroll manufactured homes as personal property.

Where the owner of the manufactured home also owns the land on which the manufactured home is situated, the assessor improperly classifies the manufactured home as improvements. For example, some manufactured homes on concrete piers, and one that had been placed on metal braces, were enrolled as improvements.

Section 5801(b)(2) provides that a manufactured home shall not be classified as real property for property tax purposes. Classification of manufactured homes as personal property has several purposes. When classified as personal property, manufactured homes may qualify as business inventory, cannot be subject to possessory interest assessments, and cannot be subject to special assessments that apply only to land and improvements.

A number of the manufactured homes we reviewed are in special assessment districts that provide vector control, flood control, and public library services. While we found no cases in

which a taxpayer has been erroneously assessed for special assessments during this survey, section 5801 provides that all improvements classified as manufactured homes must be enrolled as personal property.

We recommend that the assessor properly classify manufactured homes not on permanent foundations as personal property.

Animals

For the 2002-03 assessment year, the assessor distributed slightly more than 600 *Agricultural Property Statements*, Form BOE-571-F. This form includes a specific section for reporting taxable animals in Part II, Schedule B.

RECOMMENDATION 28: Assess all taxable animals.

The assessor assesses taxable animals inconsistently. In one case, the assessor has enrolled horses that are classified as working horses. On the other hand, the assessor did not enroll riding horses even though they are being used in the operation of a business.

All animals, unless specifically exempt, are taxable under article XIII of the California Constitution. Taxable animals include animals used in riding stable or pack station operations, rodeos, and stallions or brood mares held for breeding. Exempt animals include those used in the production of food or fiber, such as livestock and cutting horses. By assessing all taxable animals, the assessor will provide equitable treatment to owners of animals and will ensure that the correct amount of tax revenue is generated.

We recommend that the assessor assess all taxable animals.

Racehorses

Racehorses domiciled in California are subject to an annual tax in-lieu of the ad valorem property tax. Sections 5701 through 5790 outline the provisions of this tax. Specific procedures and forms are prescribed by rules 1045 and 1046. Rule 1045(a)(2) requires the assessor to furnish BOE-prescribed forms to racehorse owners for reporting the in-lieu tax.

Racehorses within the state are registered with the California Horse Racing Board. The term racehorse means each live horse, including a stallion, mare, gelding, ridgeling, colt, filly, or foal, that is or will be eligible to participate in a horseracing contest in California where pari-mutuel racing is permitted. The term also includes any horse that may produce foals that will be eligible to participate in a horseracing contest.

RECOMMENDATION 29: Develop formal procedures for the annual racehorse in lieu tax program.

The assessor has a very limited program for the discovery of racehorses. The assessor attaches a copy of Form BOE-571-J, *Report of Boarded Racehorses*, to the Form BOE-571-F, *Agricultural Property Statement*, that he annually mails to owners of agricultural properties. However, because the assessor does not receive racehorse listings from the California Horse Racing Board,

the accuracy of the returned forms cannot be verified. The assessor also does not provide the tax collector with a listing of all taxpayers to which Form BOE-571-J has been sent. However, we were able to confirm that the assessor has provided the tax collector with copies of all forms completed and returned by racehorse owners. Finally, the assessor does not perform mandatory audits of racehorse owners.

Section 5782 requires racehorse owners to report the annual in lieu racehorse tax due on forms provided by the assessor. Section 5767 imposes a penalty for failure to file such reports. Rule 1045 prescribes the assessor's responsibilities related to the taxation of racehorses. Other than providing the form BOE-571-J, the assessor must maintain a record of those persons to whom he has furnished copies of the forms. And, the assessor must provide a copy of the record to the tax collector within 10 days of when the form was furnished to the taxpayer. The assessor must retain a copy of all tax returns filed by taxpayers for a period of five years from the date the returns become due. Rule 1045(a)(3) also requires the assessor to audit the tax records of any racehorse owner who had a gross racehorse tax liability exceeding \$2,000 for each of four consecutive years. The audit is to cover the taxpayer's personal property taxes on property having tax situs at the same location and any livestock taxable at the same location.

The effect of the assessor's lack of formal racehorse assessment procedures is that these statutory and regulatory requirements have not been uniformly enforced.

We recommend the assessor develop racehorse procedures that include elements of discovery, tax collector notification, record keeping, and mandatory audit of racehorse accounts.

APPENDICES

A. County Property Tax Division Survey Group

Santa Clara County

Chief, County Property Tax Division

Mickie Stuckey

Survey Program Director:

Benjamin Tang

Principal Property Appraiser

Survey Team Supervisor:

Peter Gaffney

Supervising Property Appraiser

Survey Team Leader:

James Lovett

Senior Specialist Property Appraiser

Survey Team:

Dale Peterson

Senior Specialist Property Auditor-Appraiser

Bob Donay

Associate Property Appraiser

Jody Henning

Associate Property Appraiser

Wes Hill

Associate Property Appraiser

Bob Marr

Associate Property Appraiser

Bob Rossi

Associate Property Appraiser

Ancil Aydelott

Associate Property Auditor-Appraiser

Manny Garcia

Associate Property Auditor-Appraiser

Raymond Tsang

Associate Property Auditor-Appraiser

Marilyn Jones

Tax Technician II

B. Assessment Sampling Program

The need for compliance with the laws, rules, and regulations governing the property tax system and related assessing activities is very important in today's fiscally stringent times. The importance of compliance is twofold. First, the statewide maximum tax rate is set at one percent of taxable value. Therefore, a reduction of local revenues occurs in direct proportion to any undervaluation of property. (It is not legally allowable to raise the tax rate to compensate for increased revenue needs.) Secondly, with a major portion of every property tax dollar statewide going to public schools, a reduction in available local property tax revenues has a direct impact on the State's General Fund, which must backfill any property tax shortfall.

The BOE, in order to meet its constitutional and statutory obligations, focuses the assessment sampling program on a determination of the full value of locally taxable property and eventually its assessment level. The purpose of the BOE's assessment sampling program is to review a representative sampling of the assessments making up the local assessment rolls, both secured and unsecured, to determine how effectively the assessor is identifying those properties subject to revaluation and how well he/she is performing the valuation function.

The BOE's County Property Tax Division (CPTD) conducts the assessment sampling program on a five-year cycle for the 11 largest counties and cities and counties and on either a random or as needed basis for the other 47 counties. This sampling program is described as follows:

A representative random sampling is drawn from both the secured and unsecured local assessment rolls for the counties to be surveyed.

These assessments are stratified into 18 value strata (nine secured and nine unsecured.)

From each stratum a random sampling is drawn for field investigation, sufficient in size to reflect the assessment level within the county.

For purposes of analysis, the items will be identified and placed into one five categories after the sample is drawn:

Base year properties. Those properties the county assessor has not reappraised for either an ownership change or new construction during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling.

Transferred properties. Those properties last reappraised because of an ownership change that occurred during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling.

New construction. Those properties last reappraised to reflect new construction that occurred during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling.

Non-Proposition 13 properties. Those properties not subject to the value restrictions of article XIII A, or those properties that have a unique treatment. Such properties include mineral-producing property, open-space property, timber preserve property, and taxable government-owned property.

Unsecured properties. Those properties on the unsecured roll.

From the assessment universe in each of these 18 value strata (nine strata on both secured and unsecured local rolls), a simple random sampling is drawn for field investigation that is sufficient in size to reflect the assessment practices within the county. A simple nonstratified random sampling would cause the sample items to be concentrated in those areas with the largest number of properties and might not adequately represent all assessments of various types and values. Because a separate sample is drawn from each stratum, the number of sample items from each category is not in the same proportion to the number of assessments in each category. This method of sample selection causes the raw sample, i.e., the "unexpanded" sample, to overrepresent some assessment types and underrepresent others. "Expanding" the sample data eliminates this apparent distortion in the raw sampling; that is, the sample data in each stratum are multiplied by the ratio of the number of assessments in the particular stratum to the number of sample items selected from the stratum. Once the raw sampling data are expanded, the findings are proportional to the actual assessments on the assessment roll. Without this adjustment, the raw sampling would represent a distorted picture of the assessment practices. This expansion further converts the sampling results into a magnitude representative of the total assessed value in the county.

The field investigation objectives are somewhat different in each category, for example:

Base year properties -- for those properties not reappraised during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling: was the value properly factored forward (for the allowed inflation adjustment) to the roll being sampled? was there a change in ownership? was there new construction? or was there a decline in value?

Transferred properties -- for those properties where a change in ownership was the most recent assessment activity during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling: do we concur that a reappraisal was needed? do we concur with the county assessor's new value? was the base year value trended forward (for the allowed inflation adjustment)? was there a subsequent ownership change? was there subsequent new construction? was there a decline in value?

New construction -- for those properties where the most recent assessment activity was new construction added during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling: do we concur that the construction caused a reappraisal? do we concur with the value enrolled? was the base year amount trended forward properly (for the allowed inflation adjustment)? was there subsequent new construction? or was there a decline in value?

Non-Prop 13 properties -- for properties not covered by the value restrictions of article XIII A, or those properties that have a unique treatment do we concur with the amount enrolled?

Unsecured properties -- for assessments enrolled on the unsecured roll, do we concur with the amount enrolled?

The results of the field investigations are reported to the county assessor, and conferences are held to review individual sample items whenever the county assessor disagrees with the conclusions.

The results of the sample are then expanded as described in (5) above. The expanded results are summarized according to the five assessment categories and by property type and are made available to the assessment practices survey team prior to the commencement of the survey.

The primary use of the assessment sampling is to determine an assessor's eligibility for the cost reimbursement authorized by section 75.60. During the course of the sampling activity, the assessment practices survey team may also discover recurring causes for the differences in the opinion of taxable value that arise between the assessor and the County Property Tax Division. These discoveries may lead to recommendations in the survey report that would not have otherwise been made.

C. Relevant Statutes and Regulations

Government Code

15640. Survey by board of county assessment procedures.

- (a) The State Board of Equalization shall make surveys in each county and city and county to determine the adequacy of the procedures and practices employed by the county assessor in the valuation of property for the purposes of taxation and in the performance generally of the duties enjoined upon him or her.
- (b) The surveys shall include a review of the practices of the assessor with respect to uniformity of treatment of all classes of property to ensure that all classes are treated equitably, and that no class receives a systematic overvaluation or undervaluation as compared to other classes of property in the county or city and county.
- (c) The surveys may include a sampling of assessments from the local assessment rolls. Any sampling conducted pursuant to subdivision (b) of Section 15643 shall be sufficient in size and dispersion to insure an adequate representation therein of the several classes of property throughout the county.
- (d) In addition, the board may periodically conduct statewide surveys limited in scope to specific topics, issues, or problems requiring immediate attention.
- (e) The board's duly authorized representatives shall, for purposes of these surveys, have access to, and may make copies of, all records, public or otherwise, maintained in the office of any county assessor.
- (f) The board shall develop procedures to carry out its duties under this section after consultation with the California Assessors' Association. The board shall also provide a right to each county assessor to appeal to the board appraisals made within his or her county where differences have not been resolved before completion of a field review and shall adopt procedures to implement the appeal process.

15641. Audit of Records ; Appraisal Data Not Public.

In order to verify the information furnished to the assessor of the county, the board may audit the original books of account, wherever located; of any person owning, claiming, possessing or controlling property included in a survey conducted pursuant to this chapter when the property is of a type for which accounting records are useful sources of appraisal data.

No appraisal data relating to individual properties obtained for the purposes of any survey under this chapter shall be made public, and no state or local officer or employee thereof gaining knowledge thereof in any action taken under this chapter shall make any disclosure with respect thereto except as that may be required for the purposes of this chapter. Except as specifically provided herein, any appraisal data may be disclosed by the board to any assessor, or by the board or the assessor to the assessee of the property to which the data relate.

The board shall permit an assessee of property to inspect, at the appropriate office of the board, any information and records relating to an appraisal of his or her property, including "market data" as defined in Section 408. However, no information or records, other than "market data," which relate to the property or business affairs of a person other than the assessee shall be disclosed.

Nothing in this section shall be construed as preventing examination of that data by law enforcement agencies, grand juries, boards of supervisors, or their duly authorized agents, employees, or representatives conducting an investigation of an assessor's office pursuant to Section 25303, and other duly authorized legislative or administrative bodies of the state pursuant to their authorization to examine that data.

15642. Research by board employees.

The board shall send members of its staff to the several counties and cities and counties of the state for the purpose of conducting that research it deems essential for the completion of a survey report pursuant to Section 15640 with respect to each county and city and county. The survey report shall show the volume of assessing work to be done as measured by the various types of property to be assessed and the number of individual assessments to be made, the responsibilities devolving upon the county assessor, and the extent to which assessment practices are consistent with or differ from state law and regulations. The report may also show the county assessor's requirements for maps, records, and other equipment and supplies essential to the adequate performance of his or her duties, the number and classification of personnel needed by him or her for the adequate conduct of his or her office, and the fiscal outlay required to secure for that office sufficient funds to ensure the proper performance of its duties.

15643. When surveys to be made.

(a) The board shall proceed with the surveys of the assessment procedures and practices in the several counties and cities and counties as rapidly as feasible, and shall repeat or supplement each survey at least once in five years.

(b) The surveys of the 10 largest counties and cities and counties shall include a sampling of assessments on the local assessment rolls as described in Section 15640. In addition, the board shall each year, in accordance with procedures established by the board by regulation, select at random at least three of the remaining counties or cities and counties, and conduct a sample of assessments on the local assessment roll in those counties. If the board finds that a county or city and county has "significant assessment problems," as provided in Section 75.60 of the Revenue and Taxation Code, a sample of assessments will be conducted in that county or city and county in lieu of a county or city and county selected at random. The 10 largest counties and cities and counties shall be determined based upon the total value of locally assessed property located in the counties and cities and counties on the lien date that falls within the calendar year of 1995 and every fifth calendar year thereafter.

(c) The statewide surveys which are limited in scope to specific topics, issues, or problems may be conducted whenever the board determines that a need exists to conduct a survey.

(d) When requested by the legislative body or the assessor of any county or city and county to perform a survey not otherwise scheduled, the board may enter into a contract with the requesting local agency to conduct that survey. The contract may provide for a board sampling of assessments on the local roll. The amount of the contracts shall not be less than the cost to the board, and shall be subject to regulations approved by the Director of General Services.

15644. Recommendations by board.

The surveys shall incorporate reviews of existing assessment procedures and practices as well as recommendations for their improvement in conformity with the information developed in the surveys as to what is required to afford the most efficient assessment of property for tax purposes in the counties or cities and counties concerned.

15645. Survey report; final survey report; assessor's report.

(a) Upon completion of a survey of the procedures and practices of a county assessor, the board shall prepare a written survey report setting forth its findings and recommendations and transmit a copy to the

assessor. In addition the board may file with the assessor a confidential report containing matters relating to personnel. Before preparing its written survey report, the board shall meet with the assessor to discuss and confer on those matters which may be included in the written survey report.

(b) Within 30 days after receiving a copy of the survey report, the assessor may file with the board a written response to the findings and recommendations in the survey report. The board may, for good cause, extend the period for filing the response.

(c) The survey report, together with the assessor's response, if any, and the board's comments, if any, shall constitute the final survey report. The final survey report shall be issued by the board within two years after the date the board began the survey. Within a year after receiving a copy of the final survey report, and annually thereafter, no later than the date on which the initial report was issued by the board and until all issues are resolved, the assessor shall file with the board of supervisors a report, indicating the manner in which the assessor has implemented, intends to implement, or the reasons for not implementing the recommendations of the survey report, with copies of that response being sent to the Governor, the Attorney General, the State Board of Equalization, the Senate and Assembly and to the grand juries and assessment appeals boards of the counties to which they relate.

15646. Copies of final survey reports to be filed with local officials.

Copies of final survey reports shall be filed with the Governor, Attorney General, and with the assessors, the boards of supervisors, the grand juries and assessment appeals boards of the counties to which they relate, and to other assessors of the counties unless one of these assessors notifies the State Board of Equalization to the contrary and, on the opening day of each regular session, with the Senate and Assembly.

Revenue and Taxation Code**75.60. Allocation for administration.**

(a) Notwithstanding any other provision of law, the board of supervisors of an eligible county or city and county, upon the adoption of a method identifying the actual administrative costs associated with the supplemental assessment roll, may direct the county auditor to allocate to the county or city and county, prior to the allocation of property tax revenues pursuant to Chapter 6 (commencing with Section 95) and prior to the allocation made pursuant to Section 75.70, an amount equal to the actual administrative costs, but not to exceed 5 percent of the revenues that have been collected on or after January 1, 1987, due to the assessments under this chapter. Those revenues shall be used solely for the purpose of administration of this chapter, regardless of the date those costs are incurred.

(b) For purposes of this section:

- (1) "Actual administrative costs" includes only those direct costs for administration, data processing, collection, and appeal that are incurred by county auditors, assessors, and tax collectors. "Actual administrative costs" also includes those indirect costs for administration, data processing, collections, and appeal that are incurred by county auditors, assessors, and tax collectors and are allowed by state and federal audit standards pursuant to the A-87 Cost Allocation Program.
- (2) "Eligible county or city and county" means a county or city and county that has been certified by the State Board of Equalization as an eligible county or city and county. The State Board of Equalization shall certify a county or city and county as an eligible county or city and county only if both of the following are determined to exist:
 - (A) The average assessment level in the county or city and county is at least 95 percent of the assessment level required by statute, as determined by the board's most recent survey of that county or city and county performed pursuant to Section 15640 of the Government Code.
 - (B) For any survey of a county assessment roll for the 1996-97 fiscal year and each fiscal year thereafter, the sum of the absolute values of the differences from the statutorily required assessment level described in subparagraph (A) does not exceed 7.5 percent of the total amount of the county's or city and county's statutorily required assessed value, as determined pursuant to the board's survey described in subparagraph (A).
- (3) Each certification of a county or city and county shall be valid only until the next survey made by the board. If a county or city and county has been certified following a survey that includes a sampling of assessments, the board may continue to certify that county or city and county following a survey that does not include sampling if the board finds in the survey conducted without sampling that there are no significant assessment problems in the county or city and county. The board shall, by regulation, define "significant assessment problems" for purposes of this section, and that definition shall include objective standards to measure performance. If the board finds in the survey conducted without sampling that significant assessment problems exist, the board shall conduct a sampling of assessments in that county or city and county to determine if it is an eligible county or city and county. If a county or city and county is not certified by the board, it may request a new survey in advance of the regularly scheduled survey, provided that it agrees to pay for the cost of the survey.

Title 18, California Code of Regulations

Rule 370. Random selection of counties for representative sampling.

(a) **SURVEY CYCLE.** The board shall select at random at least three counties from among all except the 10 largest counties and cities and counties for a representative sampling of assessments in accordance with the procedures contained herein. Counties eligible for random selection will be distributed as equally as possible in a five-year rotation commencing with the local assessment roll for the 1997–98 fiscal year.

(b) **RANDOM SELECTION FOR ASSESSMENT SAMPLING.** The three counties selected at random will be drawn from the group of counties scheduled in that year for surveys of assessment practices. The scheduled counties will be ranked according to the size of their local assessment rolls for the year prior to the sampling.

(1) If no county has been selected for an assessment sampling on the basis of significant assessment problems as provided in subdivision (c), the counties eligible in that year for random selection will be divided into three groups (small, medium, and large), such that each county has an equal chance of being selected. One county will be selected at random by the board from each of these groups. The board may randomly select an additional county or counties to be included in any survey cycle year. The selection will be done by lot, with a representative of the California Assessors' Association witnessing the selection process.

(2) If one or more counties are scheduled for an assessment sampling in that year because they were found to have significant assessment problems, the counties eligible for random selection will be divided into the same number of groups as there are counties to be randomly selected, such that each county has an equal chance of being selected. For example, if one county is to be sampled because it was found to have significant assessment problems, only two counties will then be randomly selected and the pool of eligible counties will be divided into two groups. If two counties are to be sampled because they were found to have significant assessment problems, only one county will be randomly selected and all counties eligible in that year for random selection will be pooled into one group.

(3) Once random selection has been made, neither the counties selected for an assessment sampling nor the remaining counties in the group for that fiscal year shall again become eligible for random selection until the next fiscal year in which such counties are scheduled for an assessment practices survey, as determined by the five-year rotation. At that time, both the counties selected and the remaining counties in that group shall again be eligible for random selection.

(c) **ASSESSMENT SAMPLING OF COUNTIES WITH SIGNIFICANT ASSESSMENT PROBLEMS.** If the board finds during the course of an assessment practices survey that a county has significant assessment problems as defined in Rule 371, the board shall conduct a sampling of assessments in that county in lieu of conducting a sampling in a county selected at random.

(d) **ADDITIONAL SURVEYS.** This regulation shall not be construed to prohibit the Board from conducting additional surveys, samples, or other investigations of any county assessor's office.

Rule 371. Significant assessment problems .

(a) For purposes of Revenue and Taxation Code Section 75.60 and Government Code Section 15643, "significant assessment problems" means procedure(s) in one or more areas of an assessor's assessment

operation, which alone or in combination, have been found by the Board to indicate a reasonable probability that either:

- (1) the average assessment level in the county is less than 95 percent of the assessment level required by statute; or
 - (2) the sum of all the differences between the board's appraisals and the assessor's values (without regard to whether the differences are underassessments or overassessments), expanded statistically over the assessor's entire roll, exceeds 7.5 percent of the assessment level required by statute.
- (b) For purposes of this regulation, "areas of an assessor's assessment operation" means, but is not limited to, an assessor's programs for:
- (1) Uniformity of treatment for all classes of property.
 - (2) Discovering and assessing newly constructed property.
 - (3) Discovering and assessing real property that has undergone a change in ownership.
 - (4) Conducting mandatory audits in accordance with Revenue and Taxation Code Section 469 and Property Tax Rule 192.
 - (5) Assessing open-space land subject to enforceable restriction, in accordance with Revenue and Taxation Code Sections 421 et. seq.
 - (6) Discovering and assessing taxable possessory interests in accordance with Revenue and Taxation Code Sections 107 et. seq.
 - (7) Discovering and assessing mineral-producing properties in accordance with Property Tax Rule 469.
 - (8) Discovering and assessing property that has suffered a decline in value.
 - (9) Reviewing, adjusting, and, if appropriate, defending assessments for which taxpayers have filed applications for reduction with the local assessment appeals board.
- (c) A finding of "significant assessment problems," as defined in this regulation, would be limited to the purposes of Revenue and Taxation Code Section 75.60 and Government Code Section 15643, and shall not be construed as a generalized conclusion about an assessor's practices.

ASSESSOR'S RESPONSE TO BOE'S FINDINGS

Section 15645 of the Government Code provides that the assessor may file with the BOE a response to the findings and recommendation in the survey report. The survey report, the assessor's response, and the BOE's comments on the assessor's response, if any, constitute the final survey report.

The Santa Clara County Assessor's response begins on the next page. The BOE has no comments on the response.

County of Santa Clara

Office of the County Assessor

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October 24, 2003

David J. Gau, Deputy Director
Property Taxes MIC: 63
State Board of Equalization
450 N Street
Sacramento, California 95814

Dear Mr. Gau,

Enclosed is my response to the recommendations contained in the State Board of Equalization's Assessment Practices Survey of the Assessor's Office, pursuant to Section 15645 of the California Government Code. The SBE audit provides an independent and professional examination of the assessment practices and procedures in my office.

As the independently elected Assessor for Santa Clara County, the California State Constitution holds me directly responsible for the accurate, timely and efficient production of the annual assessment roll. Similarly, the State Board of Equalization performs a vital "oversight" role which is met, in part, by the comprehensive Assessment Practices Survey. The SBE's oversight responsibility is designed to protect the integrity of the property tax system and ensure the confidence of both the taxpaying public and government agencies who benefit directly from the revenue generated by accurate assessments.

Effective administration of the assessment function is of critical importance to local government. In Santa Clara County the property tax system generates in excess of \$2.4 billion for schools, cities, the county, redevelopment agencies and special districts. Moreover, the SBE has a unique authority to levy significant financial sanctions if an Assessor fails to meet an established compliance standard. This statutory requirement sets a 95% compliance ratio as the threshold to continue to collect the administrative costs of supplemental assessments. This reimbursement to Santa Clara County totaled \$7.1 million for fiscal year 2002-03. The fact that your survey team concluded that our

David Gau
October 24, 2003
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office not only met the 95% compliance ratio, but achieved a total ratio of 99.25%, is a tribute to the dedication and professional competence of our entire staff.

I am pleased that the survey team acknowledged the numerous changes and substantial improvements in our operation since your last Assessment Practices Survey published in 1998.

I sincerely appreciate the constructive analysis of our operations and recommendations for improvement. You will note that we have already addressed and resolved many of the recommendations cited in the report. In all but three recommendations, we have agreed with your analysis.

In other areas, we must continue to evaluate our financial and staff resources to ensure that they are utilized in the most efficient and productive manner possible. In response to the 1998 Assessment Practices Survey, I indicated that we must improve the way we prioritize our responsibilities and direct declining resources, human and financial, where they will generate the highest beneficial return on our public investment. That is especially true during these difficult financial times for local government. I was elected with a mandate to streamline public operations, in addition to the design and implementation of a performance-based management system that ensures the prudent allocation of public resources to prevent the "expenditure of a dollar to collect a dime."

I wish to express my appreciation to the survey team for the professional manner in which the survey was conducted, with a minimum of disruption to our operations. Their cooperative attitude and constructive comments throughout the process are acknowledged by all members of my management team.

Finally, I want to acknowledge and thank the employees of the Assessor's Office for their dedication and commitment to excellence. As noted in the survey, the 2001-02 assessment roll was completed "on time and under budget," with an assessment ratio of 99.25%-- truly an outstanding accomplishment.

Sincerely,

A handwritten signature in black ink, appearing to read "Lawrence E. Stone". The signature is written in a cursive, flowing style.

Lawrence E. Stone
Assessor

Attachment

RECOMMENDATION 1: *Use certified appraisers to value aircraft and vessels.*

We agree and have already implemented a procedure that valuations are to be reviewed and signed by a certified appraiser.

RECOMMENDATION 2: *Obtain fire reports from local fire departments to discover property damaged or destroyed by a misfortune or calamity*

We agree and will engage in efforts to secure fire reports on a periodic basis from all fire departments in Santa Clara County .

RECOMMENDATION 3: *Grant disaster relief for all qualifying calamities provided in rule 139*

We disagree with this recommendation.

The recommendation can not be implemented due to litigation. The Assessor, along with the California Assessors' Association, disagrees with the SBE's interpretation of Revenue and Taxation Code Section 170 as promulgated in Rule 139. The Assessor has joined other counties in a legal challenge (538 action) to the Constitutional validity of Rule 139. Should the Court rule in favor of the SBE the Assessor will implement the recommendation.

RECOMMENDATION 4: *Properly apply the low-value property exemption.*

We agree and have made the necessary corrections. In the vast majority of situations we have properly applied the low value property exemption.

RECOMMENDATION 5: *Use the correct version of BOE-prescribed forms.*

We agree and have implemented a procedure to ensure compliance.

RECOMMENDATION 6: *Timely return all forms checklists to the BOE.*

We agree and have implemented a procedure to ensure compliance.

RECOMMENDATION 7: *Submit final prints of all forms as required by rule 171 (a).*

We agree and have implemented a procedure to ensure compliance.

RECOMMENDATION 8: *Correctly identify penalty and escape assessments on the current assessment roll, as required by section 533 and Rule 261.*

We agree with this recommendation and will implement it with the new computerized assessment system currently being developed.

Currently the Assessor codes each petition transmitted to the Tax Collector to indicate that a penalty has been added pursuant to Revenue and Taxation Code §463, §501, §502, §503, or §504. For example, when the petition indicates a penalty assessment under §463, the Tax Collector adds the following message to the tax bill:

“Escape (Late) Assessment for 2003-2004, Section 531.0 R&T Code. Includes 10% penalty, Section 463 R&T Code.”

RECOMMENDATION 9: *Include only that information on the list of transfers that is required by section 408.1.*

We agree and have implemented this recommendation.

RECOMMENDATION 10: *Apply an appropriate depreciation allowance to the value of newly constructed additions to existing improvements.*

We agree, in principle, with this recommendation. However, in practice the cost effectiveness of implementing this recommendation, which provides little assessment benefit, does not meet our standards for efficient administration of the property tax system. Therefore, it will not be implemented at this time. This is a recommendation where the cost incurred is greater than the benefit received.

RECOMMENDATION 11: *Deduct a capital replacement allowance for irrigation wells that contribute to the income being capitalized.*

We agree with this recommendation. However, this recommendation is very resource-intensive, and due to staffing and resource limitations we will not be able to implement it at this time. Santa Clara County is an urban county. We do not track the location and age of wells and related equipment for agricultural properties.

RECOMMENDATION 12: *Establish base year values for CLCA property*

We disagree with this recommendation. The conclusion of the SBE audit team is inaccurate. Factored base year value information for CLCA property is available in the real property record, although it has not been entered into the computer program for all parcels. The factored base year value is always determined from the record and entered into the computer program when a

property goes into non-renewal status. Factored base year values for all CLCA property will be added to the computer program on an ongoing basis as time and resources permit.

RECOMMENDATION 13: *Properly calculate the income charge to nonliving improvements*

We agree and have implemented this recommendation.

RECOMMENDATION 14: *Enroll the lesser of current market value or restricted value as the base year value of taxable government owned land*

We agree and have implemented this recommendation.

RECOMMENDATION 15: *Reappraise month-to-month possessory interests only at the expiration of the anticipated term of possession as provided in section 61(b)(2)*

We agree and implemented this recommendation for the 2003-04 assessment roll.

RECOMMENDATION 16: *Correctly classify and assess leasehold improvements.*

Please see the response to Recommendation 17.

RECOMMENDATION 17: *Investigate all reported leasehold improvement costs.*

We agree with these recommendations. We currently make every reasonable effort to correctly classify and assess leasehold improvements as well as investigate leasehold improvement costs when appropriate. However, limitations of staff and resources result in inadequate time during the intense processing season to contact every assessee to determine whether leasehold improvements have been accurately reported. As an alternative, Santa Clara County determines the classification of leasehold improvements at the time of the audit and by referral to the Real Property Division when the reported cost is in excess of \$100,000. The audit process provides sufficient time for the level of investigation needed to properly resolve complex leasehold improvement issues.

We believe our procedures provide adequate safeguards to insure that reported leasehold costs are correctly assessed and classified when correctly reported by the assessee. We also believe we take appropriate steps to investigate all reported costs in excess of \$100,000 and in those instances where the reported costs are less than \$100,000 and we have reason to believe that the information provided on the Business Property Statement is incorrect. We continually work with assessees and their accountants to improve their understanding of proper reporting methodology and would welcome any assistance that the BOE could provide, including improved instructions.

To improve the accuracy of the filings and subsequent audits the Assessor has proposed legislation clarifying what records must be retained by the Assessee.

RECOMMENDATION 18: *Ensure that all equipment is properly assessed upon termination of lease.*

We agree with this recommendation and will endeavor to implement appropriate procedures when sufficient staff resources are available. We anticipate including detailed lessee information in the database as the new assessment system is developed. When that data is available electronically we will develop reports and procedures that will facilitate review upon lease termination. Currently, determination of proper assessee and assessability are made during the audit process.

RECOMMENDATION 19: *Include only accounts with a cost of less than \$100,000 in the direct billing program.*

We agree with this recommendation and have corrected the accounts referenced in the survey. Further, we have modified the direct billing procedures to prevent this situation from recurring.

RECOMMENDATION 20: *Properly classify and consistently assess biopharmaceutical industry equipment*

We agree with this recommendation and it is being implemented as qualifying entities are identified.

It should be noted that all of these accounts were subsequently revalued, either through an audit or through the appeals process, to reflect the biopharmaceutical lives as contained in the CAA Position Paper 99-004.

RECOMMENDATION 21: *Make estimated assessments based upon available information, as required by section 501.*

We agree with this recommendation. and will begin implementing it for lien date 2004. Complete implementation will be accomplished with the implementation of the new computer system.

RECOMMENDATION 22: *Properly assess personal property in apartments.*

We agree with this recommendation.

Beginning with the 2003 lien date, we changed our method of assessing apartment owners' personal property. We assess historical costs reported by the taxpayer on Form 571-R, plus any costs of personal property referred by the Real Property Division at the time the property transferred ownership. We will only use estimated amounts when the taxpayer fails to file Form 571-R.

RECOMMENDATION 23: *Use Assessors' Handbook Section 581 as intended.*

We disagree with the SBE's position that the recommended California Assessors' Association tables are arbitrary. The minimum percent good factor, equal to 125 percent of the estimated economic life, is consistent with the SBE's AH581 recommendation for developing the maximum recommended equipment index factors. The CAA's recommendations are supported by the experience derived from business property appraisals, audits, and appeals cases of senior auditor-appraisers in Assessors' offices throughout the State.

Assessors' Handbook 504, Assessment of Personal Property and Fixtures, October 2002, page 156, states, "The auditor, therefore, must apply generally accepted auditing standards and utilize generally accepted accounting and appraisal principles." Generally accepted accounting principles (GAAP) requires the recognition of salvage value, if appropriate. When supported by independent evidence, significant asset impairment or lack of marketability is recognized, and additional adjustments to value are made.

The minimum percent good factors recommended by the CAA and utilized by the Assessor are also generally supported by industry equipment salvage values identified in the *Marshall Valuation Service* publication.

RECOMMENDATION 24: *Appraise vessels at market value.*

We agree with the recommendation and will, to the extent that staff resources are available, commence a study to determine fair and reliable market values for vessels situated in this county.

RECOMMENDATION 25: *Use the Board of Equalization’s manufactured home unit cost tables as intended.*

This recommendation has been implemented.

RECOMMENDATION 26: *Apply the inflation factor as required by section 75.18 for changes in ownership of manufactured homes that occur between January 1 and June 30.*

This recommendation has been implemented.

RECOMMENDATION 27: *Enroll manufactured homes as personal property*

We agree with the recommendation.

The Assessor acknowledges that mobile homes without permanent foundations that are owned by the fee owner of the land have been treated as real property and enrolled on the Secured Roll. The Assessor will implement changes in assessment procedures to ensure that these mobile homes are assessed as personal property on the Secured Roll.

RECOMMENDATION 28: *Assess all taxable animals.*

We agree with the recommendation. We will attempt to locate all taxable animals used by stables and horse training facilities, by using the yellow pages of telephone books, and trade associations’ publications. Once these businesses are discovered, we will mail the appropriate reporting forms.

RECOMMENDATION 29: *Develop formal procedures for the annual racehorse in lieu tax program.*

We agree with this recommendation and developed the requested procedures effective for lien date January 1, 2003.