



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION  
1020 N STREET, SACRAMENTO, CALIFORNIA  
(PO BOX 1799, SACRAMENTO, CALIFORNIA 95808)  
(916) 445-4982

GEORGE R. REILLY  
First District, San Francisco  
ERNEST J. DRONENBURG, JR.  
Second District, San Diego  
WILLIAM M. BENNETT  
Third District, San Rafael  
RICHARD NEVINS  
Fourth District, Pasadena  
KENNETH CORY  
Controller, Sacramento  
DOUGLAS D. BELL  
Executive Secretary

November 30, 1979

No. 79/204

TO COUNTY ASSESSORS:

**NEWLY CONSTRUCTED PROPERTY**

The enactment of Assembly Bill 1488 has made it necessary to revise Property Tax Rule 463 (Newly Constructed Property). The purpose of this letter is to elaborate on:

- (1) What constitutes new construction?
- (2) What is valued when new construction is present?
- (3) What appraisal techniques are appropriate in the valuation of new construction?

Also included are questions and answers demonstrating the applicable valuation principles.

**What Constitutes New Construction?**

Rule 463 defines new construction in four general categories:

- (1) "Any substantial addition to land or improvements, including fixtures...." This definition is clearly stated and needs no further elaboration.
- (2) "Any substantial physical alteration of land which constitutes a major rehabilitation of the land or results in a change in the way the property is used." The key here is that the alteration must be "substantial" before new construction can be valued. Minor alteration would not qualify as new construction even if a change in use was present.

Examples of alterations that would qualify as new construction are:

- a. Land leveling
- b. Extensive site preparation prior to building
- c. Terracing of a hillside
- d. Clearing of brush-covered parcel

- e. Developing of alkali land for farming
- f. Development of rural land into subdivision
- g. Development of gravel pit

Examples of alterations to land that may not qualify as new construction are:

- a. Releveling of existing row crop land
  - b. Pulling of orchard trees for replanting. However if trees are removed for subdivision development, the cost of removal should be considered.
  - c. Rebuilding of levees or ditches
  - d. Minor site preparation prior to building
- (3) "Any physical alteration of any improvement which converts the improvement or any portion thereof to the substantial equivalent of a new structure or portion thereof or changes the way in which the portion of the structure that has been altered is used." (Emphasis added.)

Note that the definition covers portions of improvements as well as whole structures and that only one of the qualifications (change in use or new equivalency) need be present.

Examples of alterations to improvements that would qualify as new construction are:

- a. The complete renovation of an older structure or portion thereof
- b. The conversion of a portion of a warehouse to office space
- c. The conversion of a garage to living area
- d. The conversion of an existing room to a bathroom
- e. The conversion of a single-family residence to a duplex

Excluded would be those alterations where there is no change in use and the alteration did not result in new equivalency for any portion of the improvements. Examples are:

- a. Maintenance and repairs
- b. Redecorating
- c. Replacement of existing kitchen or bathroom cabinets in a home

d. Replacement of a home air conditioner

- (4) "Any substantial physical rehabilitation, renovation or modernization of any fixture which converts it to the substantial equivalent of a new fixture or any substitution of a new fixture." The rule further defines "fixture" and states how substantial equivalency is determined.

For purposes of this section, the term fixture is limited to a business fixture. This definition of new construction is not intended to apply to household fixtures such as stoves, plumbing, lighting, etc.

Excluded from the general definition of new construction are all maintenance and repair work, and property reconstructed following a disaster that meets certain qualifications. The valuation of property restored following a disaster will be covered in another assessor letter.

The valuation of construction in progress has not changed from the prior rule. Such property is appraised at its full value on each lien date until the date construction is completed. When completed, the newly constructed property shall be reappraised at its full value and that value enrolled as the base value. The date of completion will determine the base year.

If a construction project is completed in stages, with some of the improvements available for occupancy prior to the completion of the total project, base years and base year values can be separately established for the completed portions without regard to the incomplete status of the total project.

#### What is Valued When New Construction is Present?

The basic valuation principles are (1) only the value attributable to the new construction will be added and (2) the newly constructed property will have a new base year determined by the date of completion. Specifically excluded from consideration are increments of value attributable to changes in economic conditions (inflation, etc.) and changes in allowable use (zoning, etc.).

Rule 463 includes an example of land valuation where the physical alteration of the land triggers the appraisal of the new construction. The same basic premise holds true for newly constructed improvements.

If any substantial portion of an existing improvement is removed prior to the new construction, the factored base year value of the removed portion must be subtracted from the current taxable value prior to the addition of the value contributed by the new construction.

#### Appraisal Techniques

In determining the value of newly constructed property it is possible to use all three approaches to value. As in all appraisals, the direct market approach is the preferred approach if data are available. The application of this approach involves the comparison of the market value of the

property with the alteration to the market value of the property without the alteration, both values being determined as of the date of completion of the new construction.

In many instances the cost approach may be the only practical approach, but it has inherent weaknesses. The appraiser must be careful to include all applicable costs and to deduct costs of "tear outs" prior to determining the final value of the new construction. A discussion of the application of the various approaches to value in the valuation of new construction is contained in assessors' letter 78/188, Principles of New Construction Valuation, October 30, 1978.

The enclosed questions and answers illustrate the application of these provisions. If you have any questions regarding this, please contact John McCoy of our staff.

Sincerely,

Verne Walton, Chief  
Assessment Standards Division

VW:sk

QUESTIONS AND ANSWERS PERTAINING TO NEWLY CONSTRUCTED PROEPRTY

1. QUESTION: How would you appraise a 1,500 square foot residence with a 1975 base Year that has a 500 square foot garage converted to living are in February 1979?

ANSWER: Assume 1975 base year value of \$50,000 (\$15,000 land and \$35,000 Improvements). In 1979, similar 1,500 square foot homes are selling for \$90,000 with garages (\$25,000 land, \$65,000 improvements). Homes with 500 square foot garage conversions are selling for \$95,000 (\$25,000 land and \$70,000 improvements).

Value attributable to garage conversions equals \$5,000.  
Value enrolled for 1979:

Land	=	\$15,000 x 1.0824	=	\$16,236
Improvements	=	\$35,000 x 1.0824	=	<u>37,884</u>
Factored base year value			=	\$54,120
Plus value of conversion			=	<u>5,000</u>
				\$59,120

2. QUESTION: The owner of a Victorian single-family residence converts the property to a duplex by adding a kitchen to the second floor and an exterior staircase for access. A dilapidated stairway on the interior is removed. Would this conversion be subject to reappraisal?

ANSWER: Yes. This physical alteration also leads to a change in use. Value attributable to the new construction can be added to the property. However, any value attributable to normal appreciation that might occur between the base year and the completion of the alteration cannot be added.

3. QUESTION: An almond orchard is subdivided into residential lots. How will the land be valued once the lots are developed but prior to the sale of the individual parcels?

ANSWER: By estimating the difference in value of the land in the before and after condition at the time of construction. In the before condition, the land is to be considered undeveloped residential subdivision land (not an almond orchard). The value in the after condition represents that of the completed subdivision. The difference is that value which can be attributed to the "new construction" of land. We suggest that both the market approach (value comparison of an undeveloped subdivision with a developed subdivision) and the cost approach be considered. The value attributable to the new construction is added to the factored base year value of the land as in question number 1.

4. QUESTION: A vacant residential lot has been held by the same owner for ten years and the 1975 base year value is \$10,000. A house was built in February 1979 and the February 1979 full market value of the unimproved lot was \$20,000. How would the lot be valued?

ANSWER: After site improvement (leveling, site preparation or foundation excavation) the February 1979 value of the land is \$22,500. Therefore, the land value in the before condition (at time of construction) is \$20,000 and the land value in the after condition is \$22,500. The difference between the two is \$2,500 and this value is concluded to be the land value added by the new construction. The 1979 taxable land value would be computed in the following way:

1975 base value \$10,000 x 1.0824	=	\$10,824
Value attributable to new construction	=	2,500
1979 taxable land value	=	\$13,324

5. QUESTION: A home with 1,200 square feet has three bedrooms and one bathroom. It has a 1975 base year value of \$43,000 (\$13,000 land and \$30,000 improvements). In September 1978 the owners added another bathroom in what had been a closet and part of a bedroom. How would this change be valued?

ANSWER: The work was done by a licensed contractor at a cost of \$6,000. The owner reported that \$1,000 was the cost of tearing out existing structure to begin work on the bathroom. None of the other homes in this area were built with two bathrooms and no sales can be found of homes with second bathrooms added. The 1979 value via the cost approach would be:

Land - \$13,000 x 1.0824	=	\$14,071
Improvements - \$30,000 x 1.0824	=	32,472
		\$46,543
Value added for bathroom (\$6,000 - \$1,000)	=	5,000
		\$51,543

6. QUESTION: How is a completely renovated residence (the equivalent of new) with a 1975 base year value appraised?

ANSWER: Assume the residence (improvement) has a 1975 base year value of \$30,000 and the house is completely renovated in February 1979. We estimate the February unrestored improvement value to be \$50,000. After renovation, the February 1979 value is \$75,000. Therefore, the value difference in the before and after condition is \$25,000. This amount is added to the indexed base year improvement value (\$30,000 x 1.0824 = \$32,472 + \$25,000 = \$57,472).

Thus \$57,472 becomes the 1979 taxable value for the improvements which is added to the indexed land value (the base year land value remains unchanged as there was no physical alteration or addition to the land).

7. QUESTION: If a kitchen is extensively altered by adding built-ins, extending counter tops, adding new cabinets and removing or adding portions of walls, is this considered new construction?

ANSWER: If, in the opinion of the assessor, the kitchen is now the equivalent of a new kitchen, it can be considered newly constructed. If, however, the work is considered remodeling or maintenance, it would not qualify as new construction.