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May 9, 1991

No. 83/59

TO COUNTY ASSESSORS:

VALUATION OF NEW CONSTRUCTION:
PROPERTY SUBJECT TO GOVERNMENTAL RESTRICTIONS ON WATER SERVICE

As drought conditions persist in most areas of the state, governmental restrictions on water service hookups will likely become more commonplace. Further, as the restrictions tighten, their effect on the value of real property will become more pronounced. This letter sets forth the Board staff's views on the proper assessment of real property affected by restrictions on water service. Similar governmental restrictions may be accounted for in the same manner.

Fact Situation

As an example, assume permits for water service in a residential development are allocated to lots from a waiting list. The closer a lot is to the top of the list, the more value is ascribed by the market to the position on the list. When a permit for water services finally issued, and the owner develops the lot, substantial value may arise solely from the fact of the water service.

As development of the lot progresses, a base year value must be established for any completed new construction. The new construction may be completed in stages; for example, the water hookup may be installed along with other land improvements, followed by construction of a residence. The problem for assessors is to value the new construction without enrolling value attributable to the allocation of a water permit.

Legal Authority

State Constitution Article XIII A, Section 2, subdivision (a), provides in part that "full cash value" means the March 1, 1975 full cash value or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred. The implementation of this provision is found in Revenue and Taxation Code Section 110.1(a), which similarly provides that full cash value means the fair market value on the 1975 lien date or, thereafter, the value on the date on which a purchase or change in ownership occurs or the date on which new construction is completed.

For the purposes of these provisions, Revenue and Taxation Code, Section 70 defines "new construction" as either (1) any addition to real property, or (2) any alteration of land or of any improvement which constitutes a major rehabilitation thereof or which converts the property to a different use. It is important to note that this definition divides new construction into two types,

additions and alterations. Revenue and Taxation Code, Section 71 requires the assessor to determine the new base year value for the portion of any taxable real property which has been newly constructed. It goes on to expressly provide, "The base year value of the remainder of the property assessed, which did not undergo new construction, shall not be changed."

These provisions are interpreted by the Board's Property Tax Rule No. 463 "Newly Constructed Property." Subdivision (a) of Rule No. 463 provides, in part, that when real property is newly constructed after the 1975 lien date, the assessor shall ascertain the full value of the newly constructed property as of the date of completion. It further states, "This will establish a new base year full value for only that portion of the property which is newly constructed, whether it is an addition or alteration." The subdivision also expressly states, "The full value of new construction is only that value resulting from the new construction and does not include value increases not associated with the new construction."

Subdivision (b) of Rule No. 463 goes on to further define the term "new construction" and reflects the statutory categories of additions and alterations. Subdivision (b)(1) includes in the definition any substantial addition to land or improvements and cites as examples, landfill, retaining walls, curbs, gutters or sewers, etc. Subdivision (b)(2) refers to a substantial physical alteration of land which constitutes a major rehabilitation or results in a change in the way the property is used. Examples of the alterations include site developments of rural land for the purpose of establishing a residential subdivision, converting rolling, dry grazing land to irrigated crop land, and preparing a vacant lot for use as a parking facility. The subdivision also expressly states that only the value of the alteration should be added to the base year value of the pre-existing land and that increases in land value caused by appreciation or a zoning change rather than new construction should not be enrolled.

Finally, the report of the Assembly Revenue and Taxation Committee "Property Tax Assessment", dated October 29, 1979, Vol. I, discusses new construction at pages 30-33. The committee discussion recognizes the two standards for determining what constitutes new construction. These standards are additions and alterations. The discussion also makes it clear that only that portion of the property which is newly constructed may be reappraised. The report states, at page 33, "The apparent end result is that, given two identical homes, one of which is newly constructed and the other which changes ownership, on the same date, the home which changes ownership will have a higher valuation, because all factors affecting value are taken into account, whereas the newly constructed home will exclude value attributed to inflationary land values. (See examples in Rule No. 463(b)(2)."

The statute and regulation, as well as the Assembly Revenue and Taxation Committee report, make it rather clear that, as a matter of law, the assessor, when establishing the base year value of newly constructed property, is limited to the value of the particular addition or alteration. As stated in Rule No. 463, the full value of the new construction is only the value resulting from the new construction. It does not include value attributable to appreciation or zoning changes or other factors not related to the new construction. This is the legal standard that must be applied in determining the value of new construction.

Board Position

The Board staff's view is that the provisions of the statutes and regulations discussed above were intended to prevent enrollment of increases in market value of the type that occur as the result of the issuance of use or development permits, such as for water service, by the proper governmental

authority. Such increases are akin to those resulting from a zoning change and cannot be recognized in the base year value until the property changes ownership.

Accordingly, our view is that the cost approach is normally the best method of valuing new construction where substantial value may be attributable solely to the fact that the new construction has been permitted. A sales comparison approach could be reliably employed only by comparing sales of lots with the work permits granted but no work completed to sales of lots with the permitted work completed.

Sincerely,

Verne Walton, Chief
Assessment Standards Division

VW:wpc
AL-04B-2088B