STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)
TELEPHONE (916) 324-2642
FAX (916) 323-3387
www.boe.ca.gov

May 3, 2001

Honorable Kenneth D. Stieger, Assessor
County of Sacramento
700 H Street, Room 3720
Sacramento, CA 95814-1284

Attention: Mr. Gary Young, Chief Real Property Appraiser

Re: The Assessibility of Transferred Wetland Credits.

Dear Mr. Young:

This is in reply to your letter to San Joaquin County Assessor Gary Freeman dated October 2, 2000 regarding the assessibility of transferred wetland credits in response to Supervising Tax Counsel Kristine Cazadd's May 4, 2000 memorandum on the subject of wetland mitigation banks. Please excuse the delay in responding, as previously scheduled Board matters have occupied our time.

As discussed further below, it is our opinion that wetland credits do not constitute a taxable fee interest in real property as such credits are not considered "new construction." Wetlands credits relate to zoning and development restrictions and the purchase of such credits does not transfer a present interest in real property and should not be treated as an appraisable event.

Law and Analysis

Supervising Tax Counsel Kristine Cazadd addressed the following issue in her May 4, 2000 memorandum on the subject of wetland mitigation banks:

Should the transfer of "Wetlands Credits" be treated as an appraisable event?

No. Wetlands credits do not represent the transfer of a present interest in real property, but are comparable to offsite improvements adding value to the land.

Revenue and Taxation Code section 60[1] states that "[a] 'change in ownership' means 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 interest." The purchase and transfer of wetlands credits do not constitute a taxable fee interest in real property, as no transfer of a present interest in the real property from which the credits originate occurs. As such, the transfer of such credits does not result in a change in ownership of real property under the definition provided by section 60.

[1] Unless otherwise indicated, all statutory references are to the Revenue and Taxation Code.

Wetlands credits are purchased by landowners, who, in order to obtain development permits, must mitigate the wetland loss caused by the property development. Wetlands credits are analogous to zoning and development fees, compliance with which does not result in an increase of land values. Subsection (b)(2)(A) of Property Tax Rule 463 states that "[i]ncreases in land value caused by appreciation or a zoning change rather than new construction shall not be enrolled." Board staff has long held that government exactions, like zoning requirements or restrictions on use, do not result in a change in ownership of that property.[2] Page 131 of Assessors' Handbook Section 502 (AH 502), *Advanced Appraisal*, discusses zoning and development fees:

> Impact fees, certain development fees, and off-site improvements may reflect non-assessable enhancements of land value, rather than assessable new construction. When using actual costs to value new construction, appraisers should distinguish between costs attributable to new construction and those costs that may enhance the value of the land but are not costs related to additions or alterations of real property.
>
> Consider this example. A large-scale industrial complex is built adjacent to a major freeway. As part of the development, the builder agrees to (1) construct new freeway off-ramps leading to the complex; (2) widen the major streets adjoining the development, and (3) purchase and dedicate a separate parcel of land for wildlife preservation. Although each of these activities may enhance the value of the complex, it is possible that the costs associated with these activities enhance the land value, and should not be included in the new construction valuation of the improvements. [Emphasis added.]

As noted from the quotation of AH 502 above, wetlands credits are similar to off-site improvements, as a developer may incur such costs in order to obtain approval for a project. Regarding wetlands credits, the purchaser of credits is simply paying for an off-site improvement to real property owned by someone else, in order to meet governmental requirements to obtain a development permit for landowner's project. While recognizing that the purchase of wetlands credits may enhance the value of a property (i.e., the property whose development prompted the requirement for the purchase of the wetlands credits), the Board considers wetlands credits similar to off-site improvements, in that the value associated with the purchase of such credits should not be reflected in the value of the property under development. Instead, the purchase of the wetlands credits should be considered a value enhancement to the subject property's land value that may be considered upon a future change in ownership but is not assessable as new construction.

The reasoning behind this conclusion is found in the California Constitution and in the statutory definition of "new construction" or "newly constructed." Section 2(a) of article XIII A of the California Constitution states 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.[3] Subdivision (a) of section 70 defines "newly constructed"

---

[2] See Annotation 220.0900, as previously noted in Kristine Cazadd's May 4, 2000 memorandum.

[3] Subdivision (a) of section 110.1 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.*

and "new construction" as either (1) any addition to real property, or (2) any alteration of land or of an improvement which constitutes a major rehabilitation thereof or converts it to a different use. This section thus expressly divides the definition of "new construction" into two physical categories, additions and alterations. Section 71 prescribes in general terms what is assessable as new construction and what is not. Section 71 states that the assessor shall determine the new base year value for the portion of any taxable real property which has been newly constructed, but also states that the assessor shall not change the base year value of the remainder of the property which did not undergo new construction.

In order to meet the definition of "new construction," there are two fundamental requirements: (1) the construction must be either an addition to or an alteration of the land (or improvement), and (2) the addition or alteration must be made to or on the property being assessed. The second requirement is further clarified in subsection (b)(2)(A) of Property Tax Rule 463, which states more fully that

> In any instance in which an alteration is substantial enough to require reappraisal, only the value of the alteration shall be added to the base year value of the preexisting land or improvements. Increases in land value caused by appreciation or a zoning change rather than new construction shall not be enrolled.

This subsection reflects a recommendation made in the Report of the Assembly Revenue and Taxation Committee, "Property Tax Assessment," Vol. 1, October 29, 1979, which discussed (at pages 30-33) the fact that only that portion of the property that is newly constructed should be reappraised. On page 33, the report explains the treatment of assessable new construction:

> The apparent end result is that, given two identical homes, one of which is newly constructed and the other of 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. [Emphasis added.]

The legal standard therefore, established by the Legislature and implemented by Board rule is that the added full value of new construction does not include value increases attributable to general changes in economic conditions, zoning or general plan changes, or other factors that are not part of new construction. In AH 502 (page 131), the Board, in effect, applied this legal standard to zoning and development fees and off-site improvements. That is, zoning and development fees and off-site improvements are not new construction on the subject property, and, therefore, must be treated in a manner similar to value increases resulting from changes in economic conditions or "other factors."

The purchase of wetlands credits falls squarely within the category of "changes from other factors" for several reasons. First, wetlands credits are not an addition or an alteration to the land being developed, and, therefore, cannot qualify as "new construction" to that property. Second, adding any value to a parcel as the result of the amount required to be spent purchasing wetlands credits, would violate the standard set forth in subsection (b)(2)(A) of Rule 463—namely, that only the value of the new construction on the land being assessed shall be enrolled. Third, adding value to a parcel that results from activity not on the parcel is what the implementing statutes and rules for valuing new construction under article XIII A of the California Constitution (i.e., "Proposition 13") were intended to prevent. In this respect, this situation is not unlike the example set forth in subsection (b)(2)(A) of Rule 463, which illustrates

that a $10,000 increase in land value upon completion of new construction cannot be added by the assessor when valuing the new construction.[4] Finally, like economic or other changes, the value added to a site because of amounts spent purchasing wetlands credits, will be reflected in the market place and will be so recognized in the property's sale price—when the property changes ownership. At that time, the enhanced market value would also be reflected in the reassessment due to the change in ownership.

In your October 2, 2000 letter, you questioned whether there was a distinction between wetlands credits and transferable development rights (TDRs) as reviewed in Mitsui Fudosan v. County of Los Angeles, (1990) 219 Cal.App.3d 525. While it is true that the Court of Appeal found that the purchase of TDRs constituted the transfer of a present "right" in real property, TDRs and wetlands credits are distinguishable from each other. Wetlands credits do not transfer any part of the bundle of rights arising from the ownership of a wetland mitigation bank site to a permittee. Nothing in the wetlands mitigation statutes indicates that the conveyance of wetlands credits to a permittee constitutes a transfer of rights that would meet the change in ownership test of section 60. Furthermore, as an expressed standard condition in an agreement to sell wetlands credits, the credits sold are non-transferable and non-assignable and do not transfer any real property rights to a permittee.

Wetlands credits and TDRs can be further distinguished by the fact that TDRs are development rights that have gone unused by the seller. In other words, TDRs come into existence regarding a property and have value because the property was not fully developed, such that the TDRs represent an unused "right" in the property. The seller of TDRs had development rights to his property, but has decided to not fully exercise these rights. With the sale of the TDRs, the seller loses his right in perpetuity to further develop his property.

Wetlands credits, on the other hand, have no such characteristics. A purchaser of wetlands credits must purchase these credits as a prerequisite for development, but the seller ("bank") continues to own the wetlands. The seller of wetlands credits, a wetlands mitigation bank, does not lose an unused "right" as the result of selling wetlands credits. In fact, a wetlands mitigation bank benefits from the sale of wetlands credits, as the sales proceeds cover the costs of the mitigation bank site.[5] Additionally, wetlands credits are not identifiable to a specific purchaser's property but to the "bank" and are therefore assessable "new construction" on the seller's bank site. As such, the transfer of wetlands credits should not be treated as an appraisable event, since the wetlands remain assessable to the seller ("bank").

---

[4] Rule 463 (b)(2)(A) – In any instance in which an alteration is substantial enough to require reappraisal, only the value of the alteration shall be added to the base year value of the pre-existing land or improvements. Increases in land value caused by appreciation or a zoning change rather than new construction shall not be enrolled, for example:

1. Land value 1975 = $10,000
2. Land value 1978 = $20,000
3. Value of alteration 1978 = $5,000
4. Value of structure added 1978 = $75,000

1979 roll value (1+3+4) = $90,000 (must be adjusted to reflect appropriate indexing)

[5] Subdivision (b) of Fish and Game Code section 1794 provides that "The payment shall provide for purchase of bank site wetland acreage required by Section 1793 that has the same hydrologic, vegetative, and other characteristics as the system for which it will serve as mitigation."

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

Anthony S. Epolite
Tax Counsel

ASE:eb
Prop/prec/Restrict/Epolite/01/01ase.doc

cc: Honorable Gary Freeman
San Joaquin County Assessor

Mr. Richard Johnson, MIC:63
Mr. David Gau, MIC:64
Mr. Charlie Knudsen, MIC:62
Ms. Jennifer Willis, MIC:70