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Executive Director

January 17, 2001

**Subject: *New Construction Issues – Request for Legal Opinion***

Dear Mr.       :

This is in reply to your letter of November 29, 2000 addressed to Senior Tax Counsel Kristine Cazadd in which you request our opinion as to several issues involving new construction and change in use of real property. The facts presented and the specific questions posed in your letter are restated below followed by our responses.

**Facts Presented**

A taxpayer purchased a warehouse on January 1, 1998 for \$100 per square foot (psf) allocated as \$60 psf to land and \$40 psf to the building. The price included land and the unrenovated core and shell of the building with existing tenants, but did not include existing tenant improvements. The assessor enrolled the purchase price as the new base year value.

The building underwent seismic renovation which was completed in July 1999. Shortly thereafter, the taxpayer leased the building as office space. The total cost of renovation was \$100 psf allocated as: \$40 for T.I. allowance, \$20 psf for construction costs excluded as new construction pursuant to Revenue and Taxation Code sections 74, 74.5 and 74.6; and \$40 for construction costs not excluded as new construction. As of the completion of the new construction, the fair market value of the property was \$300 psf. For purposes of this analysis, you ask us to assume that a warehouse property in unrenovated core and shell condition would sell for \$200 psf.

**Questions Presented**

**1. Change in use:**

a) Was there a change in use of the subject property?

**Yes.**

Property Tax Rule 463, subdivision (b)(3) provides in relevant part that “new construction” means and includes “[a]ny physical alteration of any improvement which . . . changes the way in which the portion of the structure that had been altered is used, e.g., . . . alterations to warehouse to that makes it usable as retail store or restaurant.” As the example indicates, the renovation project resulted in a change in use because it converted the use of the building from a warehouse to office space.

- b) If affirmative, what was the point in time it occurred?

Property Tax Rule 463.500, subdivision (b) provides that

the date of completion of the new construction resulting from actual physical new construction on the site shall be the earliest of either the date upon which the new construction is available for use by the owner or if all of the conditions of paragraph (b)(1) are satisfied, the date the property is occupied or used by the owner, or with the owner’s consent, after the owner has provided a notice in accordance with paragraph (b)(1).

Under the facts presented, the new construction was completed and the change in use occurred in July 1999 because the property was available for use as leased office space at that time.

- c) At the time of change in use, can the Assessor reassess the entire property, including the land and unrenovated core and shell that have previously set base year values?

**No.**

The assessor is required to appraise only the full cash value of the qualifying new construction. Property Tax Rule 463, subdivision (b)(2)(A) provides 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 pre-existing land or improvements. Increases in land value caused by the appreciation or a zoning change rather than new construction shall not be enrolled.

Thus, the assessor may not reappraise the values of the land and that portion of the improvements that were not subject to new construction. See Assessors’ Handbook Section 502, *Advanced Appraisal*, page 115, enclosed, which states that “value added by the physical alteration is assessable, but the value attributable solely to the change in use is not.” Additionally, the assessor may not appraise the value of any new construction for which statutory exclusions are applicable.

## 2. Certification:

- a) Section 72 of the Revenue and Taxation Code mandates the Building Department to transmit a copy of the building permit or the certificate of occupancy to the Assessor. Does this transmission meet the requirement of Sec. 74.5(c), if the Building Department subsequently signs off (or approves, or certifies) on the permit that was specifically identified to relate to seismic improvements?

**No.**

The statutes have different purposes and compliance requirements. Under Section 72, subdivision (a), the county or city agency that issues building permits is required to transmit a copy of any building permit to the county assessor as soon as possible after the date of issuance. Subdivision (b) requires that the city or county agency that issues or finalizes certificates of occupancy or other documents showing date of completion of new construction to transmit each such document to the county assessor within 30 days after the date of issuance or finalization. Thus, under those provisions, the city or county agency is required to provide to the assessor the documentation recording the commencement and completion of the new construction.<sup>1</sup>

Under Section 74.5, subdivision (c)<sup>2</sup>, the property owner, primary contractor, civil engineer, or architect is required to certify “to the building department those portions of the project that are seismic retrofitting improvements or improvements utilizing earthquake hazard mitigation technologies.” Furthermore, under subdivision (c), when the project is completed, the building department is required to report the value of those portions of the project that are seismic retrofitting improvements and improvements utilizing earthquake hazard mitigation technologies to the county assessor.

The building department cannot meet its requirement under subdivision (c) of reporting to the assessor “the value of those portions of the project that are seismic retrofitting improvements and improvements utilizing earthquake hazard mitigation technologies” until the “property owner, primary contractor, civil engineer, or architect” has met its required duty under subdivision (c) of certifying those portions of the project to the building department. Thus, the submission of the building permit or certificate of occupancy would not, by itself, satisfy the requirements of section 74.5, subdivision (c). Furthermore, the building permit or certificate of occupancy would probably only show that seismic improvements had been performed but would not identify the portion of the project attributable to those improvements. Finally, the requirement that the building department report to the assessor the value of those portions of the project that are seismic improvements would not be met because the building permit and certificate of occupancy does not include the required value information.

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<sup>1</sup> Section 72 was added to the Revenue and Taxation Code in July 1983 as part of SB 813 (Stats. 1983, Ch. 498) as part of the statutory scheme for supplemental assessments.

<sup>2</sup> Section 74.5 is the legislative implementation in AB 43 (Stats. 1991, Sh. 8), a 1990 constitutional amendment that provided a blanket exclusion from new construction for earthquake-related improvements.

- b) If not, what if the owner sends a letter to the Building Department and includes the cost estimate of all activities related to Excluded Costs as provided by the architect or general contractor - would this meet the requirements of Section 74.5?

**Yes.**

The letter would satisfy the first requirement of section 74.5, subdivision (c) assuming that the portion of the project that is seismic retrofitting improvements or improvements utilizing earthquake hazard mitigation technologies can be determined from those costs and the architect or general contractor certifies the truth and accuracy of the costs. The letter would also comply, in whole or in part, with the requirement of subdivision (d) of section 74.5 that the property owner submit "all documents necessary to support the exclusion."

- c) If the owner submitted costs described in 2)b) and the Building Department did not transmit the required value to the Assessor, then what is the taxpayer's recourse to avoid losing the exclusion?

Even though subdivision (c) imposes the reporting requirement on the building department, there is no statutory provision that would prohibit the taxpayer from providing that information directly to the assessor. Subdivision (d) of section 74.5 provides that a taxpayer shall submit all information regarding the exclusion directly to the Assessor. In our view, if the value information were not submitted by the building department, and such information is "necessary to support the exclusion" claimed by the property owner, the assessor has a duty to evaluate the information submitted and determine whether the exclusion applies.

### **3. New Construction:**

- a) Let's assume that the fee simple value of the subject property as of date of completion, \$300 psf, can be attributed to land, core and shell and T.I., evenly at \$100 each. Can the Assessor assess the T.I. at \$100 psf even though the cost was \$40 psf?

**Possibly.**

The assessor is required to determine the full cash value of any new construction and to establish that value as the base year value. In this regard, Property Tax Rule 463, subdivision (a) provides in relevant part

(a) When real property, or a portion thereof, is newly constructed after the 1975 lien date, the assessor shall ascertain the full value of such "newly constructed" property as of the date of completion. 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 taxable value on the total property shall be determined by adding the full value of new construction to the taxable value of preexisting property reduced to account for the taxable value of property removed during construction. 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.

As with any other new construction, the full cash value of tenant improvements may not equal the costs of constructing them. Therefore, the assessor should exercise caution in relying on the cost approach, and should check values derived from the original cost against values derived from other value approaches. Where the new construction involves income-producing property, such as the subject property, the value of the new construction may be estimated by using the income approach. Application of any approach, however, must meet the requirements of Rule 463, subdivision (a), such that “[t]he 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.” See Assessors’ Handbook, Section 502, Advanced Appraisal, at pages 128 and 129 enclosed.

- b) If the taxpayer did nothing more than filing the exclusion claims and informing the Assessor of the costs of excluded items, can the Assessor include the Excluded Costs in the assessment?

As explained in 3(a), the base year value of new construction is established, not by enrolling the costs of new construction, but rather by determining the full cash value on the completion date. Thus, if new construction qualifies for an exclusion or exclusions, the assessor is required to exclude the *value* of that new construction, which value may not necessarily equal its cost, from the new base year value of the total new construction.

In order to claim the exclusion from new construction provided by either section 74.5 or section 74.6, a property owner is required to notify the assessor prior to, or within 30 days of, completion of the project that he or she intends to claim the exclusions covered by those sections. The property owner is also required to file a claim form and all documents necessary to support the exclusion within the time periods prescribed by those sections. Once the taxpayer has provided notice and filed the required documents, the assessor determines whether and to what extent the claimed new construction qualifies for the applicable exclusion or exclusions. As stated above, if the assessor determines that the new construction qualifies for an exclusion, then the value that portion of the new construction may not be included in the base year value established for the total new construction.

- c) Can certain repair and maintenance costs, such as re-roofing and exterior painting, be excluded from the assessment, even though they are not specifically excluded by law?

**Yes.**

Such repair and maintenance *is* specifically excluded by law as new construction. Property Tax Rule 463, subdivision (b)(4) provides that

(4) Excluded from alterations that qualify as “newly constructed” is construction or reconstruction performed for the purpose of normal maintenance and repair, e.g., routine annual preparation of agricultural land or interior or exterior painting, replacement of roof coverings or the addition of aluminum siding to improvements or the replacement of worn machine parts.

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Therefore, any value increase resulting from maintenance and repair would not be included in the determination of full cash value for the purpose of establishing a base year value for new construction. See Assessors' Handbook, Section 502 at pages 118 and 119, enclosed.

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,

/s/ Lou Ambrose

Lou Ambrose  
Tax Counsel

Attachments [AH 502, December 1998 edition, pages 115, 118-119, 128-129]

LA:tr

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cc:

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