either making the land value or the improvement value residual to the other component, in practice the land value is estimated and subtracted from the total value to derive the value attributable to the improvements. Land is not generally subject to depreciation, and its value may be estimated by direct comparison with sold properties, a technique seldom applicable to improvements alone.

LIMITATIONS OF THE COMPARATIVE SALES APPROACH

The comparative sales approach is very reliable in an active market in which there are numerous recent sales of comparable properties. It is the preferred approach when reliable market data is available.

However, two primary factors limit the usefulness of this approach. First, certain types of property are infrequently sold, with the result that there may be insufficient market evidence to derive a valid indicator by direct comparison. Where few comparable sales exist, or the comparable properties are not close substitutes for the subject, it is difficult to make comparisons. An appraiser using the comparative sales approach under these circumstances is forced to make many subjective adjustments to the market data. Second, the conditions of each comparable sale must be carefully investigated before it can be used as an indicator of value. Many sales do not meet the conditions of an open market transaction and are not good indicators of market value. In spite of these limitations, comparative sales are usually a more accurate index of market value than any other available evidence.

STOCK AND DEBT APPROACH

The stock and debt approach is a variation on the comparative sales approach. It is included in rule 3 as an acceptable approach to value. This approach is based on the fundamental accounting equation stating that the value of a corporation or other business organization's assets equals the value of its liabilities plus its net worth.

The stock and debt approach relies on values for an organization's liabilities and net worth (i.e., the values of its debt and equity interests) as established in the capital markets; it thus relies on the value of fractional interests in the company. To use the approach, the securities of the company whose taxable property is being appraised must be publicly traded. The current market value of the company's stock (equity) is added to the current market value of its liabilities (debt). Using the fundamental accounting equation, the sum of these amounts equals the total value of all corporate assets as valued in the capital market. This approach values all of the assets of the corporation, taxable and nontaxable. Therefore, the appraiser must make adjustments for the value of any nontaxable assets. These adjustments should be based on the value the capital market places on the nontaxable assets.

The stock and debt approach has several limitations:

1. It cannot be applied to companies that have little or no public trading of their securities.
2. The adjustments for nontaxable assets may be difficult to make.

3. Typical stock prices do not effectively measure the advantages of ownership and control that are inseparable in non-corporate or closely-held corporate property. This is often evidenced by the fact that the purchase of enough stock to gain control of the corporation is typically made at a price above the stock's market price.
4. Stock and debt securities are generally highly liquid in contrast to the physical assets against which they represent claims. The aggregate value of the stock and debt securities may include a liquidity premium above the value of the physical assets.

Despite these limitations, the stock and debt approach has some validity because it is based on the valuation of a corporation's assets by market participants.

INCOME APPROACH

INTRODUCTION

The income approach to value includes any method of converting an income stream into a present value estimate (i.e., an indicator of current fair market value). The income approach is also called the capitalization approach because capitalization is the process of converting an expected income into an indicator of value. In addition to the following discussion, see Chapter 4 of Assessors' Handbook Section 504, *Advanced Appraisal*, for information on advanced issues in the income approach.

The methods or techniques used in the income approach may be relatively simple (e.g., income or rent multipliers and direct capitalization), or more complex (e.g., various yield capitalization techniques). All of these methods are referred to as capitalization techniques because they convert an expected future income stream into a present value estimate.

The income approach requires careful application because small variations in its key variables (capitalization rate, duration of income stream, estimated income and expenses, etc.) will be mathematically leveraged into a wide range of estimated value. This is particularly true for the capitalization rate variable. The accuracy of the income approach is no greater than the validity of the assumptions used to estimate the key variables. The mathematical techniques used in the approach, while sometimes complicated, are merely tools for converting these assumptions into an estimate of current market value.

APPLYING THE INCOME APPROACH FOR PROPERTY TAX PURPOSES

Rule 8 prescribes the conditions under which the income approach may be applied. Subdivision (a) specifies that:

> The income approach to value is used in conjunction with other approaches when the property under appraisal is typically purchased in anticipation of a money income and either has an established income stream or can be attributed a real or hypothetical income stream by comparison with other properties. It is the preferred approach for the appraisal of land when reliable sales data for

> comparable properties are not available. It is the preferred approach for the appraisal of improved real properties and personal properties when reliable sales data are not available and the cost approaches are unreliable because the reproducible property has suffered considerable physical depreciation, functional obsolescence or economic obsolescence, is a substantial over- or underimprovement, is misplaced, or is subject to legal restrictions on income that are unrelated to cost.

Subdivision (b) states that in using the income approach, "an appraiser values an income property by computing the present worth of a future income stream."

Subdivision (c) establishes that the amount to be capitalized is the net return that a reasonably well informed owner and reasonably well informed buyers may anticipate that the taxable property existing on the valuation date will yield, considering prudent management and subject to such legally enforceable restrictions as such persons may foresee as of that date. It states, in part:

> Net return, in this context, is the difference between gross return and gross outgo. Gross return means any money or money's worth which the property will yield over and above vacancy and collection losses, including ordinary income, return of capital, and the total proceeds from sales of all or part of the property. Gross outgo means any outlay of money or money's worth, including current expenses and capital expenditures (or annual allowances therefor) required to develop and maintain the estimated income. Gross outgo does not include amortization, depreciation, or depletion charges, debt retirement, interest on funds invested in the property, or rents and royalties payable by the assessee for use of the property. Property taxes, corporation net income taxes, and corporation franchise taxes measured by net income are also excluded from gross outgo.

Subdivision (d) states that in "valuing property encumbered by a lease, the net income to be capitalized is the amount the property would yield were it not so encumbered, whether this amount exceeds or falls short of the contract rent and whether the lessor or the lessee has agreed to pay the property tax." Thus, the estimate of economic rent for income-producing property must be made without regard to actual lease arrangements that may exist, including rent levels and property tax payment considerations, since the valuation objective is the market value of the unencumbered and unrestricted fee simple interest.

Subdivision (e) recommends using income from property rental rather than from business operation, since income derived from business operation is more likely to be influenced by managerial skills and may arise in part from nontaxable property or other sources. If income from business operation must be considered, sufficient income must be excluded to provide a return to working capital, any other nontaxable intangible assets and rights, and unpaid or underpaid management.

Subdivision (f) requires the inclusion of a property tax component, where applicable, equal to the estimated future ad valorem portion of the tax rate for the area times the assessment ratio, in the capitalization rate for all property tax appraisals.[88]

Subdivision (g) provides the following two methods of developing a capitalization rate for property tax appraisals: (1) by comparing the net incomes that could reasonably have been anticipated from recently sold comparable properties with their sales prices adjusted, if necessary, to cash equivalents (the market-derived rate); or (2) by deriving a weighted average of the capitalization rates for debt and for equity capital appropriate to the California money markets (the band-of-investment method) and adding increments for expenses that are excluded from outgo because they are based on the value being sought or the income being capitalized. In the former, the appraiser determines the ratio of net income to adjusted selling prices of comparable sales to develop a range of yield or overall rates. Subdivision (g)(1) states that this method is preferred when the required sales prices and incomes are available. In the latter, the appraiser derives a weighted average of current rates for debt and equity capital (subject to the inclusion of a property tax component).

Subdivision (h) provides that income may be capitalized by the use of gross income, gross rent, or gross production multipliers (derived by comparing sales prices of closely comparable properties with their gross income, gross rent, or gross production).

Finally, subdivision (i) excludes open space land defined in section 421 from the provisions of rule 8 and also states that not all provisions of rule 8 apply to taxable possessory interests.

ASSUMPTIONS OF THE INCOME APPROACH

The validity of using the income approach depends upon whether the subject property meets the following three assumptions: (1) value is a function of income (i.e., the property is purchased for the income it will produce); (2) value depends upon the quality and quantity of the income stream (i.e., the investor demands a return of and on his or her investment in the property with consideration of the property's risk); and (3) future income is less valuable than present income (i.e., the value of the property is the sum of the present worth of its anticipated future net benefits). If the circumstances of the subject property do not meet these three assumptions, the income approach should not be given great weight as an indicator of the property's current market value.

Value is a Function of Income

A basic assumption of the income approach is that property is purchased for the income that it will produce. It follows that a property's value depends upon the income that it will produce. This assumption has general acceptability in the appraisal of most commercial, industrial, and multiple-residential properties since the owners of these properties frequently are not the users. It

[88] Under a triple net lease, the tenant assumes all expenses of operating the property, including property taxes. If the income to be capitalized is income estimated under a triple net lease, it is not necessary to add a property tax component to the capitalization rate.

is plausible, for example, that the owner of a retail property owns it for the rental income received and that a potential purchaser would buy it for the expected future rental income. This is an important assumption, and in cases in which it does not correspond with the facts, the income approach may not apply.

In order to use the income approach, the benefits a property will provide over time must be expressed in terms of money. Benefits expressed in money are most often found in commercial, industrial, and multiple-residential properties, since these are typically developed and purchased for the income they provide and are frequently leased to tenants in competitive markets. Single-family residential properties may also be leased, but they are often developed and purchased to provide their owners with amenity benefits rather than monetary benefits. Consequently, it is often difficult to apply the income approach to single-family residences.

If the income approach is used to value property that provides both monetary and amenity benefits, care should be exercised in converting amenity benefits into value. If the capitalization rate reflects the amenity benefit, a question arises whether the amount of the amenity benefit reflected in the rate equals the amenity benefit in the subject property. For example, a farm may be both a production unit returning monetary benefits and a living unit returning amenity benefits. Because the appraiser is often unable to impute an income to the amenities from the living unit, the capitalization rate is derived from market data that is based only upon the income derived from the farm as a production unit. The capitalization rate will consequently be lower than it would have been had it been possible to impute an income to the amenities and sum the income from both benefits (i.e., monetary and amenity) to obtain a more accurate measure of the true monetary return. Capitalization rates that include both monetary and amenity elements should be used for properties that have amenities similar to those of the properties from which the respective rates were derived.

Rents are, in effect, sales prices for short-term rights to use property. Appraisers apply these short-term sales prices in the income approach to obtain value indicators, which are estimates of the present worth of the sum of all these expected future short-term sales prices. The sum may involve short-term sales prices for a terminating period or in perpetuity.

It is generally preferable that the income to be capitalized be the income from the taxable property to be appraised. For example, a retail store operated by the property owner involves at least two activities. One is the ownership of the real and tangible personal property, and the other is the business of selling merchandise at the property. It is necessary to determine what portion of the operation's expected future earnings is attributable to the ownership of the taxable property. If the earnings of the business (after deductions for operating expenses) are capitalized into an indicator of value, the appraiser should be aware that the indicator may contain the value of nontaxable intangible assets and rights. The value of such assets and rights must not be reflected in the value of the taxable property. However, taxable property may be assessed and valued by

assuming the presence of intangible assets or rights necessary to put the taxable property to beneficial and productive use.[89]

Value is Determined by the Duration of Income and Its Risk

The income approach assumes that the investor in real property will estimate the duration of the income stream and its risk, or likelihood of receipt, when selecting a capitalization rate to value the property.

For land, the estimated duration of the income stream is usually in perpetuity, but improvements have limited lives. The estimate of the remaining economic life of an improvement (that period of time over which the property will earn a net income above the rent imputable to the land alone) is an important consideration in the income approach. Average life tables have been developed as general guides to estimating remaining economic life. However, a careful study of the structural soundness of the improvements, the degree of functional obsolescence, and the economic and social trends in the neighborhood and community should serve as the primary basis for this estimate.

The risk of an income stream refers to its certainty, that is, how likely it is that the investor will receive it. The greater the uncertainty of the income, the higher the capitalization rate at which the income should be capitalized. Not all investments are subject to the same level of risk, with the result that not all income streams should be capitalized at the same rate.

Investors demand both a *return of* their investment (a recapture of the investment) and a *return on* their investment (a yield on the investment). The yield rate contains components for (1) time preference, (2) liquidity preference, (3) risk, and (4) investment management.

1. *Time preference* is the return investors demand for forgoing present consumption. Time preference reflects the pure time value of money. The minimum, or "risk free," rate is the lowest yield rate that would be acceptable if instant cash liquidity were available, there were no risk of loss, and no management effort were required. The risk-free rate is represented by the return on United States government securities, which contain no default risk and little requirement for investment management. Time preference also includes an allowance for anticipated inflation.
2. *Liquidity preference* means that investors would rather have assets that are readily convertible into cash at face value. To give up this feature may mean waiting a significant period to sell an asset, or having to sell it at a discount to realize cash quickly.
3. *Risk* refers to the uncertainty involved with any projection into the future. Investors may commit their capital to relatively secure investments such as United States Treasury securities or passbook savings accounts. When they instead invest in speculative ventures,

[89] In using the income approach, the appraiser should use the estimated economic, or market, rent attributable to the taxable property, if possible, to estimate the value of the taxable property. Using the estimated economic rent for the taxable property assures that the value, if any, of intangible assets and rights is not reflected in the value of the taxable property.

they demand to be compensated for the element of uncertainty associated with these investments.

4. *Investment Management* is that component of the yield rate that compensates the investor for personal efforts involved in making decisions between alternative investments. It is *not* compensation for the day-to-day management efforts involved in real property.

Future Income is Less Valuable Than Present Income

The third assumption of the income approach is that future income is less valuable than present income. The concept of present value, essential to an understanding of the income approach, provides that the sum of the present worth of the future income payments is *always less* than the undiscounted sum of these future payments.

This concept is one of the most important in valuation. Because investors prefer immediate returns over future returns, they "discount" future returns, or reduce their value, when analyzing investments. Because of the pure time value of money, this is true even if no risk is involved. A rational investor would not pay $1,000 today for the certain right to receive $1,000 one year hence, because he or she could earn interest on the $1,000 during the year, with the result that the total value would accumulate (at the risk-free rate of interest) to an amount greater than $1,000 at the end of the year. To the rational investor, a certain payment of $1,000 a year from today is worth something less than $1,000 today, with the amount of the discount determined by the risk-free rate of interest.

The present value is the amount which, when compounded periodically (usually annually) at a given rate, will accumulate to the future amount. For example, $1,000 due one year from today has a present value of $909.09 if the annual interest rate is 10 percent ($909.09 x 1.10 = $1,000). A series of payments made at equal intervals is known as an *annuity*. The present value of an annuity is the sum of the separate periodic incomes, discounted to their respective present worths. Factors used to convert annuities into value may be obtained from compound interest tables, personal computers, or financial calculators.[90] The process of discounting a series of annuity payments, or any future payment or payments, in order to obtain the present value of this income, is the basic theoretical underpinning of income capitalization.

CONVERSION OF INCOME INTO VALUE

The key component variables of income capitalization include: (1) the income to be capitalized; (2) the capitalization rate or factor used to convert the income into a value indicator; and (3) the time period over which the income is to be realized. The capitalization rate or factor must provide for both the *return of* the portion of the investment that declines in value (the investment amortization or recapture) and for the *return on* the investment (the yield). The means of investment recapture selected by the appraiser, as reflected in the capitalization method chosen, should reflect the expectations of buyers and sellers.

[90] Assessors' Handbook Section 505, *Capitalization Formulas and Tables*, contains annuity factors.

In its simplest form, the capitalization process may be represented by the equation $V = I/R$, where V is the indicated present value of the income stream, I is the income to be capitalized, and R is the capitalization rate. If the time during which the income is to be realized is less than perpetuity, a recapture component must be included in R. If any two elements of this equation are known, the third can be found. For example, $I = RV$ and $R = I/V$. In other words, if the income and the value of a property are known, as is the case with a comparable sale, a capitalization rate can be derived.

When capitalizing equal payment annuities of limited duration or deferred income payments, the appraiser may use annuity tables to process the future income into its present value. The factors in these tables account for the terminating nature of the income stream and hence also for recapture. The factor, F, is a ratio between value and annual net income, $F = V/I$. Since the component for recapture is included in the annuity factor, the rate used in conjunction with the tables need not reflect a recapture component. In this case, the basic capitalization formula becomes $V = IF$ rather than $V = I/R$, and capitalization becomes a matter of multiplication rather than division. The basic formula $V = IF$ also applies when using income multiplier analysis; all income multipliers are also factors.

The proper capitalization formula or method to use is a function of the shape of the income stream and should reflect the perceptions and actions of market participants. The appraiser must know the basic capitalization equations and understand the relationship between the variables in these equations before proceeding to the mechanics of the process. While specific applications may differ because of variations in the nature of the income stream or the composition of the capitalization rate, the basic principles of capitalization remain constant.

Direct capitalization is a method that converts a single year's income estimate into a value indicator in one step, either by dividing the income estimate by a capitalization rate or multiplying it by an income factor. In direct capitalization, no allocation is made between the return on and the return of the investment. This method does not explicitly specify investor assumptions regarding the return of and the return on the investment, the duration or pattern income, or changes in the value of the investment. Rather, these assumptions are implicit in the rates or income factors used, which are derived from sales of properties comparable to the property being valued. The following sections discuss the derivation of an overall capitalization rate from comparable sales and valuing a subject property using direct capitalization with an overall rate.

Income multiplier analysis is closely related to direct capitalization. A single year's gross income may be converted to an indicator of value by multiplying it by an income multiplier derived from the sales of comparable properties. This method is mathematically related to direct capitalization since a capitalization rate is the reciprocal of an income multiplier or factor (although an income multiplier is generally based on a gross level of income, while an overall capitalization rate is based on a net level of income). The following sections contain discussions of deriving a gross

income multiplier from comparable sales and valuing a subject property using a gross income multiplier.[91]

Yield capitalization is a method that converts a series of future benefits into an estimate of present value by discounting each future benefit at a selected yield rate. In yield capitalization, the appraiser: (1) estimates a holding period for the investment; (2) forecasts the expected future income during the holding period; (3) selects a yield, or discount, rate; and (4) converts future benefits into an estimate of present value by discounting each periodic income over the holding period.[92] The periodic income streams may be discounted to present value using annuity tables, which contain annuity factors. *Discounted cash flow (DCF) analysis* is a widely used "modern" form of yield capitalization. Yield capitalization is discussed more thoroughly in Chapter 4 of the Assessors' Handbook Section 502, *Advanced Appraisal*.

Again, the method of capitalization utilized must reflect the assumptions and actions of the investors who make up the market for the property being appraised. The method must fit the size, shape, and duration of the subject property's income stream. These are matters that must be determined from an analysis of the market, comparable properties, and the property being appraised. The crucial difference between the various methods of capitalization is the manner in which the investment is recaptured.

CAPITALIZATION RATES AND MULTIPLIERS

A capitalization rate is any rate used for conversion of income into value. In the appraisal of property for assessment purposes, future income is discounted to present value at a rate that reflects the pure time value of money (including an allowance for anticipated inflation); liquidity preference; risk; investment management; investment recapture; and, if applicable, a component for property taxes. The capitalization rate is based on a hoped for or anticipated rate of return on and of the investment. It is the rate required to attract capital to the investment.

Direct market evidence is the preferred source for obtaining capitalization rates. Actual selling prices (adjusted to cash equivalence) of comparable properties can be related to their anticipated incomes. The income used in rate derivation must be the investor's anticipated income, because the decision to invest in property is directly related to its anticipated return.

As previously stated, one variation of the basic capitalization equation is $R = I/V$. When V (the sale price of the property when deriving a rate) and I (the income attributable to the property) are known, the derivation of R (the capitalization rate) is a simple mathematical computation. The type of rate derived will vary according to the level of income processed. When valuing property

[91] Some appraisers consider income multiplier analysis to be a part of the comparative sales approach rather than the income approach. The significant consideration is whether the method provides a good indicator of market value for the property being appraised, not how the method is categorized.

[92] Yield capitalization can also be performed by developing an overall capitalization rate which reflects the estimated income pattern, duration, value change in the investment, and yield rate. However, microcomputer applications that allow a period by period approach to income analysis and discounting (i.e., a discounted cash flow approach) have made such techniques less popular.

the rate must be applied to the *same level of income* from which it was derived. (However, this general principle is complicated somewhat by the treatment of property taxes, which is discussed below.)

The income multiplier is another useful tool of the income approach and is simpler to apply than some forms of capitalization. All multipliers are factors and follow the second variation of the basic capitalization formula, $V = IF$. Gross income multipliers are derived by dividing the adjusted sales prices of comparable properties by their anticipated annual gross incomes. The appraiser then multiplies the estimated income by the indicated multiplier to arrive at a value indicator for the subject property, applying the multiplier to the same level of income from which it was derived. The rationale of income multiplier analysis is that both the sale price or value and the gross income of an income property are subject to the same market influences and presumably move in the same direction in response to market forces.

Overall capitalization rates and income multipliers must be derived from sales that are comparable to the subject property. The requirements for comparability include similar types of property (same use, remaining lives, condition, and land-to-improvement ratios), similar income streams, availability of similar new financing for the subject, similar market of potential purchasers, similar terms of sale, and similar market conditions prevailing at time of sale.

CHARACTERISTICS OF THE INCOME STREAM

Components of the Income Stream

When investors purchase property for its future income, they anticipate that the future income from the property will satisfy several different functions. Therefore, the income stream can be separated into several components: (1) a component to provide for all property related expenses, including vacancy and collection losses, maintenance and repair, and utilities; (2) a component to provide for the payment of the property taxes on the property; (3) a component to allow for the *return of* the investment (investment recapture); and (4) a component to allow for a *return on* the investment (investment yield), even if this return on or yield is not realized until the property is resold.

Shape of the Income Stream

An income stream is a flow of income over time. The income stream used to derive income multipliers or capitalization rates, or used to value a property, can be represented by the income from one year or over several years. An income stream can be of one pattern or shape, or a combination of several shapes: It can remain constant (level); it can increase or decrease; it can terminate at a certain point in time; or it can continue into perpetuity. In the derivation of income multipliers and capitalization rates from comparable sales, and in the use of multipliers and rates to value properties, the appraiser should be aware of the pattern or shape of the income stream expected by market participants. There are five primary income patterns to which appraisal models are applied:

1. *Constant Perpetual.* A series of equal, annual incomes that flow into perpetuity. In theory, land is a non-wasting asset and is considered to be capable of producing a constant perpetual income.
2. *Constant Terminal.* A series of equal, annual incomes that terminate at some point in the future. Terminating income streams are normally associated with wasting assets (improvements).
3. *Straight Line Declining Terminal.* A series of annual net incomes that decline in equal amounts over a period of time until the income terminates.
4. *Variable Income.* A series of annual incomes that fluctuate in various amounts from year to year. In some cases the income may be a negative amount.
5. *Single Income Payment (Reversion).* A lump sum payment that will be received at some point in time in the future.

PROCESSING THE INCOME STREAM

When the income approach is used, the appraiser processes the income to a level from which an income multiplier or capitalization rate can be derived, or to a level from which the income is capitalized into an estimate of value. "Processing" the income means subtracting out amounts of income from the total, or gross income, that a property is expected to produce. The amount of income subtracted depends on whether the appraiser is: (1) deriving a capitalization rate; or (2) capitalizing an income stream into an estimate of value using a capitalization rate. In addition, the type of income for extracting multipliers or rates from a property sale is different from the type of income used to value a property. These differences are addressed in the following sections.

DERIVING INCOME MULTIPLIERS AND OVERALL CAPITALIZATION RATES FROM COMPARABLE SALES

When deriving income multipliers or capitalization rates, the appraiser must use *anticipated income*, that is, income anticipated by the buyer in a particular transaction.[93] When deriving a gross income multiplier, the income is processed only to the level of anticipated potential gross income. When deriving an overall capitalization rate, the income is processed to the level of net income before recapture. These levels of income are summarized below:

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[93] The approaches to value described in this manual are generally appropriate for properties that are operating at stabilized occupancy and operation. Stabilized occupancy occurs when there are no transitory abnormalities of supply and demand and existing market conditions are expected to continue over the economic life of the property (Appraisal Institute, *The Appraisal of Real Estate*, 342). If the property being appraised is not operating at such a level, further refinements may be required. See Assessors' Handbook Section 502, *Advanced Appraisal*.

	Anticipated Potential Gross Income (APGI)
(*minus*)	Anticipated Vacancy and Collection Losses
equals	Anticipated Effective Gross Income (AEGI)
(*minus*)	Anticipated Operating Expenses
equals	Anticipated Net Income Before Recapture and Property Taxes (ANIBR&T)
(*minus*)	Anticipated Property Taxes
equals	Anticipated Net Income Before Recapture (ANIBR)

Deriving a Gross Income Multiplier

The investor's anticipated potential gross income (APGI) can be used to derive a gross income multiplier (GIM) by dividing the sale price, adjusted for cash equivalency, by the anticipated potential gross income. The basic formula for a gross income multiplier (GIM) is:

$$GIM = \frac{SP}{APGI}$$

where

GIM	=	the gross income multiplier, market-derived;
SP	=	the cash equivalent selling price of a comparable property; and
APGI	=	the anticipated potential gross income of comparable sale property (note: this may differ from its *actual* current income).

When appraising smaller residential properties, appraisers commonly speak of gross rent multipliers. A gross income multiplier is more useful for larger apartment projects and some commercial properties, since these types of properties frequently return income from sources other than basic building rent (e.g., income from parking, laundry facilities, or storage areas).

Deriving Overall Capitalization Rates from Comparable Sales

Subtracting the anticipated expenses, including the anticipated property taxes, from the anticipated effective gross income produces the anticipated net income before recapture (ANIBR). The anticipated net income before recapture divided by the sale price, adjusted for cash equivalency, produces a market-derived overall rate (OAR). The basic formula for deriving an OAR is:

$$OAR = \frac{ANIBR}{SP}$$

where

OAR	=	the overall capitalization rate, market-derived;
ANIBR	=	the anticipated net income before recapture of comparable sale property (note: this may differ from its actual current income); and
SP	=	the cash equivalent selling price of a comparable property.

VALUING PROPERTY USING INCOME MULTIPLIERS AND OVERALL CAPITALIZATION RATES

After the required sales and income data have been collected, analyzed, and processed to derive income multipliers and capitalization rates from comparable properties, the derived multipliers and rates are used with the correct level of income to find an indicator of value of the subject property.

When valuing property, the appraiser does not apply the individual buyer's anticipated income and expenses as were used in deriving rates. Instead, *economic, or "market," estimates of projected income and expenses are used*, that is, a level of income and expenses that would be projected by a typical purchaser of the subject property. The appraiser estimates the economic rent for the subject property using economic rents from comparable properties. Allowable expenses that a typical buyer would project are estimated based on the operating characteristics of the subject property. The reasonableness of the appraiser's projections can be checked using prevailing market rents and expenses for comparable properties under standard terms or conditions.

Ad valorem property taxes (property taxes based on property value) are not deducted as an expense when valuing property since this would presume that the value of property being appraised is already known. Instead, a property tax component is added to the overall capitalization rate. Because of the level of income involved, no adjustment for property taxes is required to the gross income multiplier.

When valuing property using a gross income multiplier, the income stream is processed to the level of economic potential gross income. When valuing property using an overall capitalization rate, the income stream is processed to the level of economic net income before recapture and property taxes. The steps in processing the income stream in order to estimate the value of the property being appraised are as follows:

	Economic Potential Gross Income (EPGI)
(minus)	Economic Vacancy and Collection Losses
equals	Economic Effective Gross Income (EEGI)
(minus)	Economic Operating Expenses
equals	Economic Net Income Before Recapture and Property Taxes (ENIBR&T)

Valuing Property Using a Gross Income Multiplier

The general formula for valuing property using a gross income multiplier is to multiply the estimated economic potential gross income (EPGI) by a gross income multiplier derived from the sales of comparable properties. Thus:

$$V = GIM \times EPGI$$

where

V	=	indicated market value of the subject property;
GIM	=	gross income multiplier selected from multipliers derived from comparable properties; and
EPGI	=	economic potential gross income of the subject property.

Example: Valuing Property Using A Gross Income Multiplier

Assume the following data:

GIM	The gross income multiplier derived from comparable properties is 6.25;
EPGI	The estimated economic level of potential gross income for the subject property is $80,000.

The indicated market value is:

$$V = GIM \times EPGI = 6.25 \times \$80{,}000 = \$500{,}000.$$

Valuing Property Using an Overall Capitalization Rate

The general formula for valuing property using an overall capitalization rate is to divide the estimated economic, or market, net income before recapture (ENIBR) by an overall rate obtained from the sales of comparable properties. However, since property taxes cannot be deducted as an expense in arriving at the income to be capitalized, the property tax appraiser capitalizes the economic net income before recapture and property taxes (ENIBR&T), using a capitalization rate that is the sum of the overall rate derived from comparable sales and the estimated ad valorem property tax rate. Thus:

$$V = \frac{ENIBR\&T}{OAR + ETR}$$

where

V	=	indicated market value of the subject property;
ENIBR&T	=	the economic net income before recapture and property taxes of the subject property;
OAR	=	the overall capitalization rate; and
ETR	=	the estimated ad valorem property tax rate.

Example: Direct Capitalization Using an Overall Rate

Assume the following:

ENIBR&T	the economic net income before recapture and property taxes of the subject property is $25,000
OAR	the overall capitalization rate selected from OARs derived from comparable sales is 0.095 (or 9.5%)
ETR	the estimated ad valorem property tax rate is 0.011 (or 1.1%)

The indicated market value using direct capitalization by an overall rate is:

$$V = \frac{NIBR\&T}{OAR + ETR} = \frac{\$25,000}{0.095 + 0.011} = \frac{\$25,000}{0.106} = \$235,849 \text{ round to } \$235,500.$$

RESIDUAL TECHNIQUES: OVERVIEW

Residual techniques of income capitalization allow an appraiser to capitalize the income allocated to an investment component of *unknown* value once all investment components of *known* value have been satisfied. Residual techniques can be applied to the physical components of a property (land and improvements) or to the financial components (debt and equity).

When using residual techniques, the appraiser: (1) applies an appropriate capitalization rate ("appropriate" in terms of the risk and return expectations of market participants) to the value of the known property component to determine the amount of income needed to support the investment in that component; (2) deducts this amount from the total economic, or market, net income before recapture and property taxes (ENIBR&T) of the subject property to derive the *residual income* available to the unknown component; (3) capitalizes the residual income into an estimate of value of the unknown component using an appropriate capitalization rate for that component; and (4) obtains a value indicator for the total property by summing the value of the known component with the estimated value of the unknown component.

Familiarization with the building and land residual techniques discussed briefly below is recommended. These techniques may be used when the required data are available.

Building Residual Technique

The building residual technique is used when the value of the land is known but the value of the improvements is unknown. After processing the estimated economic income of the subject property to the level of ENIBR&T, the income imputable to the land (the land value multiplied by the land capitalization rate) is deducted. The residual income is attributable to the building (or improvements) and may be converted to an estimate of improvement value by capitalizing it using a building capitalization rate.

The capitalization rate for the land, which assumes a constant perpetual income stream, is a combination of a yield rate and an effective tax rate. The capitalization rate for the building (improvement) is a combination of a yield rate, a recapture rate for the return of the investment in the wasting improvement, and the effective property tax rate.

Land Residual Technique

The land residual technique is used when the value of the building (improvements) is known but the value of the land is unknown. The income attributable to the building (the building value multiplied by the building capitalization rate) is deducted from the estimated ENIBR&T of the subject property. The residual income is attributable to the land and may be converted into an estimate of land value using a land capitalization rate.

The land residual technique allows the appraiser to estimate land values when comparable land sales data are not available. The technique can also be used to estimate the highest and best use of both vacant and improved sites by hypothecating potential highest and best uses and comparing the resulting indicators of land values.

LIMITATIONS OF THE INCOME APPROACH

As discussed at the outset, the income approach to value is based on the three premises that: (1) investors purchase property for its anticipated income; (2) investors estimate the duration and quality (i.e., risk) of this income; and (3) future income is less valuable than present income. If the facts regarding the property being appraised do not correspond to these premises, the income approach should not be used. If the property meets the premises of the income approach, and if income and expense forecasts, remaining economic life estimates, and capitalization rates are accurate and supported by market data, the approach produces a supportable indicator of market value.

RECONCILIATION OF VALUE INDICATORS AND THE FINAL VALUE ESTIMATE

In the appraisal process, typically more than one approach to value is applied, leading to separate indicators of value. In addition, several value indicators may also be derived from within a single approach. In the comparative sales approach, for example, each sale produces a separate indicator

of value. Multiple value indicators within a single approach, however, are generally resolved within that approach.

The final analytical step in the appraisal process is to reconcile value indicators from the separate approaches utilized into a final estimate of value. Resolving the differences among the value indicators is called *reconciliation*. The result of reconciliation is the final value estimate.

In the reconciliation process, consideration should be given to factors influencing value that are either not reflected or only partially reflected in the indicators. One should not make a simple arithmetic average of the several indicators. The greatest weight should be given to that approach or combination of approaches that best measures the type of benefits the subject property yields. [94] The reconciliation step should involve an analysis of: (1) the relative appropriateness of the approaches applied; (2) the accuracy of the data collected and calculations made in each approach; (3) the quantity of data available for each approach; and (4) the consistency in the manner in which the approaches to value were applied.

The cost estimate should be reviewed for the reliability of the depreciation estimate and whether it is supported by market data. If the sales comparison approach was used, a check should be made to determine whether the indicator relies heavily upon only one sale (a situation that is extremely undesirable). In reviewing the income approach, the appraiser should reexamine the estimates of economic rent, economic life, expenses, and capitalization rate, and alternative estimates should be considered. The appraiser should consider whether estimates are consistently optimistic or pessimistic.

Although containing an element of judgment, the analysis of value indicators should be based upon indicators derived from objective data, plus general overall value influences (economic, physical, political, and social factors). If a value indicator were perfect, it would already reflect these value influences. However, in actual practice, a value indicator is usually far from perfect. As indicated above, if the appraiser has adequate and reliable data, the greatest reliance should be placed on that indicator which best measures the type of benefits the subject property is expected to yield. These benefits may be in the form of amenities or money.

Some appraisers hold that the amount produced by the cost approach prior to the consideration of depreciation (i.e. replacement cost new of improvements plus land value) reflects the upper limit of value. Alternatively, other appraisers hold that the income approach consistently yields the lowest indicator. Both of these conclusions are generally the result of conservatism, error, or misapplication of the approaches. There is nothing inherent in any of the three primary approaches that should result in a value consistently lower or higher than those derived by the other approaches.

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[94] In the case of a change in ownership of real property other than a possessory interest, the purchase price of the property is rebuttably presumed to be the fair market value of the property at the time of the change in ownership. This presumption does not apply if the purchase price was not negotiated under the specified open-market conditions. Furthermore, the presumption may be rebutted if a preponderance of evidence, as shown by other indicators of value, demonstrates that the fair market value is significantly more or less than the purchase price.

CHAPTER 7: PERSONAL PROPERTY APPRAISAL PROGRAM

As discussed in Chapter 3, the California Constitution, article XIII, section 2 provides that the taxation of tangible personal property is discretionary with the Legislature.[95] In the Revenue and Taxation Code, the Legislature has broadly defined personal property in section 106 as follows:

> "Personal property" includes all property except real estate.

In many respects, the same basic appraisal principles that apply to real property also apply to personal property. The same definition of market value from section 110 applies to personal property as well as real property. However, unlike real property, personal property is assessed at market value every year; it is not governed by the value limitations under article XIII A of the California Constitution (Proposition 13). Except for manufactured homes and floating homes, there is no base year value for personal property and the appraisal date is always the lien date, January 1.

DIFFERENCES BETWEEN PERSONAL PROPERTY AND REAL PROPERTY

Although taxed at the same maximum percentage of market value as real property, personal property is treated differently in many other respects.

- Special assessments are levied on real property only.
- The Legislature has wide authority pursuant to article XIII, section 2, of the Constitution concerning the taxation and/or exemption of personal property.
- Tangible personal property cannot be assessed to insurance companies, banks, and financial corporations.
- Locally assessed real property is governed by article XIII A, while personal property is appraised at market value annually.
- Unless otherwise provided by the Legislature, the tax on State and national banks shall be according to or measured by the net income and shall be in lieu of all other taxes and license fees upon banks or their shares, except taxes upon real property and vehicle registration and license fees.[96]
- There is no taxable possessory interest in personal property, except as provided for in section 201.5.
- The tax rate on the unsecured roll is the rate of the prior year's secured roll.[97]

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[95] The information covered in this chapter is only a brief summary of the appraisal issues regarding personal property; for a thorough analysis, see Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures*.
[96] Section 27 of article XIII of the California Constitution.
[97] California State Constitution, article XIII, section 12.

SITUS

The determination of the tax situs of property is an essential factor of a valid assessment, especially for personal property. Section 14, article XIII of the California Constitution clearly states:

> All property taxed by local government shall be assessed in the county, city, and district in which it is situated.

Normally, the tax situs of personal property is considered to be the location of the property. Situs is not a problem with property that remains in one location, but problems are encountered when determining the situs of transitory or migratory property. Rules 203, 204, and 205 provide direction on the situs of property in transit, movable property (e.g., contractor's equipment, boats, general aircraft, and racehorses), and leased property. Under section 623, if a taxpayer owns leased personal property situated at multiple locations in a county, the assessor may assess the property at either each location or may place a single assessment of all the leased personal property in the county at a single location.

A common situs question concerns leased property. According to rule 204, property leased on a short term basis has situs where the lessor normally keeps the property. If property is leased for a term of more than six months, the situs is determined on the basis of the lessee's use. There are numerous special situations regarding situs that are beyond the scope of this manual. Chapter 3 of the Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures* contains a comprehensive discussion of situs.

REPORTING REQUIREMENTS

Because historical cost information is a very important tool for mass appraisal, the law requires most owners of business personal property to annually report the historical cost of equipment to the assessor. The property statement is the declaration of assessable property, signed under penalty of perjury, on which business personal property is reported (See Chapter 7, Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures*.). Historical cost is used as a starting point because it normally represents the value of the property when purchased new. Additionally, it is a verifiable figure and lends itself to the mass appraisal process.

In addition to asking for costs of taxable personal property, the property statement requests a variety of other information that is needed by the assessor for making annual reviews of property. For example, although fixtures are classified as real property, they are treated as a separate appraisal unit (i.e., separate from the land and improvements) for the purpose of comparing adjusted base year value to fair market value. Since fixtures usually decline in value at approximately the same rate as personal property, the property statement requests the same information regarding fixtures as for personal property so the assessor can make the appropriate calculations.

The requirements for filing a property statement are set forth in section 441, which states, in part:

> Each person owning taxable personal property, other than a mobilehome subject to Part 13 (commencing with section 5800), having an aggregate cost of one hundred thousand dollars ($100,000) or more for any subsequent assessment year shall file a signed property statement with the assessor. Every person owning personal property that does not require the filing of a property statement or real property shall, upon the request of the assessor, file a signed property statement.

Based on this statute, a person who has taxable personal property (other than a manufactured home) in the county that cost $100,000 or more is required to file a property statement with the assessor regardless of whether the assessor requests such a filing. Filing is also required if the assessor requests the person to file a property statement. If a person is required to file a property statement (because of either the $100,000 threshold or the assessor's request) and fails to do so, under section 463 a penalty is applied to all the taxable personal property and fixtures that were subject to the reporting requirement.

The term "property statement" has a special meaning for California property tax assessment. The contents of all property statements are prescribed by the State Board of Equalization. Assessors may make limited rearrangements of the property statement for purposes of their processing needs, but the questions and instructions are uniform statewide. If an assessor needs different kinds of information or additional information than is contained in the property statement, he or she may request the taxpayer to provide such information but generally may not apply a penalty for failure to do so.[98]

Thus, in cases in which a person has less than $100,000 (at cost) of personal property, the assessor may elect to request the person to file a property statement or may elect to obtain the necessary information by some other means, such as a questionnaire or a physical inspection of the property.

Escapes and double assessments ("errors") commonly occur due to misunderstandings regarding situs, classification of property, reporting categories, etc. Such errors are especially likely to occur when there are substantial changes to a commercial or industrial property such as new construction, new tenants, or a change in ownership. For complex properties, standard property statements (and change in ownership statements) rarely contain sufficient detail to ensure that all taxable property is assessed and that no assets or portions of the property escape assessment. When a change of ownership or other major change to a property occurs, the assessor needs to take extra steps to ensure that the property is assessed correctly. In addition to field inspections, discussions with the taxpayer, and internal coordination between real property appraisers and auditor-appraisers, the assessor may ask the taxpayer to supply additional information to clarify the necessary details. Most taxpayers are likely to cooperate since they want to avoid double assessments and future escape assessments.

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[98] There is one notable exception: Assessors may request an aircraft owner to file a non-prescribed statement giving the make, model, and year of manufacture of the aircraft and will apply a 10 percent penalty for failure to do so. (Sections 5365 and 5367.)

corporations generally, is "in lieu of all other taxes and licenses, state, county and municipal, upon the said banks and financial corporations except taxes upon their property,…" As such, assessors should independently evaluate and determine, on a case by case basis, whether these entities are shown on the "Confidential List of Banks and Financial Corporations" (in a CAO) and are qualified by the Franchise Tax Board (Corporate Audit Section) as a bank or financial corporation for assessment purposes. The personal property of those qualifying as financial corporations are exempt from property tax. However, when a bank or financial corporation leases property to another party, section 235 provides that, for property tax purposes, the lessee is conclusively presumed to be the owner of the property. Accordingly, such property is taxable to the lessee.

APPRAISAL METHODS FOR PERSONAL PROPERTY

AUDIT-APPRAISAL METHOD

The audit-appraisal method is based largely on data obtained from existing business records. On a yearly basis the assessor obtains, through the property statement, historical cost information (or costs adjusted for trade level, as discussed above) and other relevant data from the property owner. The acquisition (or trade-leveled) costs are used as a starting point for the estimation of market value. All costs necessary to place the equipment into service are to be included. These include the purchase price of the equipment, sales or use tax, freight charges, installation and set-up costs, machinery foundation costs, and trade level adjustments where applicable.[102]

The historical (or trade-leveled) cost is adjusted to an estimate of current reproduction cost new through the use of a price index or to replacement cost new through the use of current prices for comparable equipment. Assessors' Handbook Section 581, *Equipment Index and Percent Good Factors* (AH 581), is published annually and provides a number of equipment index tables for commercial and industrial equipment. Current prices for replacement equipment are sometimes available from commercial publications or from the property owner.

The cost new (reproduction or replacement) is then adjusted for depreciation (depreciation is the loss of value from all causes). This is typically done through the use of percent good tables, which are also contained in the AH 581. The use of tables is intended to estimate the value of property under typical conditions.

It is possible for individual items or groups of items to suffer abnormal depreciation due to excessive wear and tear, extraordinary functional obsolescence, and/or any form of external obsolescence. On the other hand, sometimes equipment suffers less-than-typical depreciation due to better-than-normal maintenance and other factors. Adjustments should be made whenever the

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are 1) not subject to the bank and corporations in-lieu tax, 2) subject to real property tax, and 3) not subject to personal property tax. Federally-chartered entities are 1) not subject to the bank and corporation in-lieu tax, 2) subject to real property tax, and 3) subject to personal property tax.

[102] Except personal property leased for a period of six months or less (rule 10(c)) and for certain liquefied petroleum gas tanks as provided by rule 153.

standard depreciation tables do not accurately measure the actual loss of value of the equipment. Using recent sales of comparable equipment, the appraiser may be able to make a direct estimate of total depreciation from all causes.

PHYSICAL APPRAISAL METHOD

The physical appraisal method is used when accounting records are nonexistent or are inadequate for appraisal purposes, or when there are other reasons to believe that an accurate appraisal cannot be made by using the property statement or other available documents. Physical appraisal may be necessary, for example, when a business has changed owners. Since the recorded costs are just an arbitrary allocation of the total purchase price among such classifications as real property, inventory, personal property, and goodwill, the allocated value may have only a minimal relationship to market value.

The physical appraisal method requires viewing, listing, classifying, and describing property. The auditor-appraiser evaluates the condition and quality of the equipment and then estimates the replacement cost new and the depreciation to determine market value. This can be done with the help of cost and value guides for equipment that is frequently bought and sold.

AUDIT PROGRAM

AUDIT OBJECTIVES

The appraisal of most personal property is based on information submitted by the taxpayer on the property statement, as previously noted. In order for these appraisals to be reliable estimates of value, it is vital that the reported information be accurate and complete.

Assessors are required by section 469 to regularly audit the books and records of certain taxpayers. Pertaining to mandatory audits, this section states, in part:

> In any case in which locally assessable trade fixtures and business tangible personal property owned, claimed, possessed, or controlled by a taxpayer engaged in a profession, trade, or business has a full value of four hundred thousand dollars ($400,000) or more, the assessor shall audit the books and records of that profession, trade, or business at least once each four years.

Additionally, the assessor may audit the books and records of businesses below the mandatory audit level.[103]

The purpose of an audit is to determine whether existing assessments (including previous years' assessments within the statute of limitations) are correct or should be changed. A property tax *audit* (per rule 191) is a means of collecting data relevant to the determination of taxability, situs, and value of property. In order to make this determination, the auditor-appraiser collects data relevant to the determination of taxability, situs, classification, and value of property. Generally,

[103] Revenue and Taxation Code sections 441(d) and 470; rule 192(e).

this involves determining the original acquisition date, historical cost, and location of the property on the lien date. The audit is also an opportunity for the auditor to clarify correct reporting procedures with the taxpayer.[104]

STATUTORY PROVISIONS

The Legislature has provided the assessor with the statutory authority to review a taxpayer's records for information required on the property statement in the event a taxpayer is not willing to completely and/or accurately report the required information, or for any related purpose. This authority to allow the assessor to review books and records is stated in section 441(d), as follows:

> At any time as required by the assessor for assessment purposes, every person shall make available for examination information or records regarding his or her property or any other personal property located on premises he or she owns or controls.

In regard to business records, section 470(a) similarly provides:

> Upon request of an assessor, a person owning, claiming, possessing or controlling property subject to local assessment shall make available at his or her principal place of business, principal location or principal address in California or at a place mutually agreeable to the assessor and the person, a true copy of business records relevant to the amount, cost and value of all property that he or she owns, claims, possesses, or controls within the county.

STATUTORY REQUIREMENT FOR REQUESTING INFORMATION ON UNREPORTED PROPERTY

Under section 501, if the appraiser becomes aware of any unreported personal property, a written notice requesting the information required on the property statement should be sent to the owner/assessee. If no statement is filed by the owner/assessee within a reasonable time, the appraiser shall estimate the value of the property, and on the basis of the estimate, shall promptly assess the property and add a 25 percent penalty to any assessment made under section 502.

STATUTORY REQUIREMENTS FOR NOTIFYING TAXPAYER OF RESULTS

Upon completion of the audit, the assessor has the following obligation under section 469:

> Upon completion of an audit of the taxpayer's books and records, the taxpayer shall be given the assessor's findings in writing with respect to data that would alter any previously enrolled assessment.

Rule 191 requires that the taxpayer be given an opportunity to respond orally or in writing to the audit results, and any written comments become part of the audit report. If an audit reveals an overassessment, section 469 provides:

[104] See Chapter 8, Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures.*

> [T]he assessor shall notify the taxpayer of the amount of the excess valuation or misclassification, and the fact that a claim for cancellation or refund may be filed with the county as provided by sections 4986 and 5096.

In all cases, it is the auditor-appraiser's goal to determine the current market value of the taxable property. The use of tables and value guides to estimate fair market value of equipment is designed to expedite the mass appraisal process. However, these tools do not remove the need for appraisal judgment or the requirement that the ultimate assessment reflect the fair market value of the property on the appraisal date.

CHAPTER 8: SPECIAL TOPICS

APPRAISAL OF MANUFACTURED HOMES (MOBILEHOMES)

The taxation of manufactured homes, or mobilehomes, is addressed by Revenue and Taxation Code section 5800 and following. Although manufactured homes are not subject to the provisions of article XIII A of the California Constitution (Proposition 13), these statutes provide for essentially similar treatment for these properties.[105]

The Health and Safety Code generally defines a manufactured home as a structure that is transportable, is 8 or more feet in width, 40 or more feet in length, or—if erected on a site—320 or more square feet in area. Additionally, the structure must be built on a permanent chassis and designed to be used as a dwelling unit.

CLASSIFICATION

Since the amendment made to section 5801(b)(2) by Chapter 796, Statutes of 1991, effective January 1, 1992, the classification of manufactured homes is no longer an issue. The statute simply provides that manufactured homes are classified as personal property, stating, in part:

> Except as provided in paragraph (1), a manufactured home, otherwise subject to taxation pursuant to this part, shall not be classified as real property for property tax purposes that would be excluded from taxation pursuant to this part.

Only manufactured homes on permanent foundations pursuant to Health and Safety Code section 18551 are considered real property. Such homes are taxed as all other real property is taxed, are not subject to section 5800, and are not classified as manufactured homes. Although classified as personal property, most of the provisions relating to the taxation of personal property are not applicable to the taxation of manufactured homes. The primary differences in the taxation of manufactured homes from other personal property are:

1. *Secured Roll*. The assessment of a manufactured home is entered on the secured roll.[106]
2. *Payment of Taxes*. The taxes on manufactured homes may be paid in two installments.[107]
3. *Base Year Value*. A base year value is determined for a manufactured home on the date it changes ownership.[108]
4. *Declines In Value*. The taxable value of a manufactured home is the lesser of its factored base year value on the lien date, taking into account reductions in value due to any factor causing a decline in value (e.g., depreciation, damage, destruction, obsolescence, etc.).[109]

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[105] See Assessors' Handbook Section 511, *Assessment of Manufactured Homes and Parks,* for a detailed discussion.
[106] Section 5830.
[107] Section 5830(c).
[108] Section 5802.
[109] Section 5813.

5. *Supplemental Assessments*. Manufactured homes that undergo a change in ownership or new construction are subject to supplemental assessment.[110]

PERSONAL PROPERTY CHARACTERISTICS

The classification of a manufactured home as personal property rather than real property has several consequences, as outlined below.

- Personal property held for sale or lease in the ordinary course of business is exempt from taxation under the business inventory exemption (sections 129 and 219, and rule 133). Thus, if on the lien date a manufactured home is held for sale or lease (i.e., is vacant and not actually in use) by a person engaged in the business of selling or leasing such properties, the property is exempt until it is sold, at which time a supplemental assessment will be made to the new owner.
- Under the Soldiers and Sailors Civil Relief Act of 1940, military personnel on active duty in California may declare their personal property's legal situs to be outside the state and, therefore, the property is deemed to be tax exempt. The exemption does not apply to military personnel who are legal residents of California.
- The Legislature has not provided for the creation of possessory interests in personal property. Private uses of personal property owned by a governmental agency are not taxable possessory interests except for pollution control equipment financed pursuant to section 201.5.
- Personal property owned by banks, financial corporations, and insurance companies is exempt from the property tax (article XIII, sections 27 and 28 of the California Constitution). However, if a person leases or rents personal property from a bank or financial corporation, for property tax purposes the lessee is "conclusively presumed" to be the owner of that property (section 235).

Classification may also affect the amount of property tax levied since special assessments are not levied on personal property.

TAXABILITY

Section 5801 provides that a manufactured home is taxable on the local property tax roll if:

1. Sold new on or after July 1, 1980; or
2. So requested by the owner.

Owners of other manufactured homes pay license fees to the Department of Housing and Community Development.

[110] Section 75.5.

SITE VALUE

It is important to recognize that the full cash value of a manufactured home *does not* include any value attributable to a particular site. Section 5803 provides, in part:

> "[F]ull cash value" [of a manufactured home] … does not include any value attributable to the particular site where the manufactured home is located on rented or leased land which would make the sale price of the manufactured home at that location different from its price at some other location on rented or leased land. In determining the "full cash value" of such a manufactured home on rented or leased land, the assessor shall take into consideration, among other relevant factors, sales prices listed in recognized value guides for manufactured homes, including, but not limited to, the Kelly Blue Book Manufactured Housing and Mobilehome Guide and the National Automobile Dealer Association's Mobilehome Manufactured Housing Appraisal Guide.

The effect of site value on the purchase price of a manufactured home can be either positive or negative. In situations where negative site values exist, it is the land, not the manufactured home, that is entitled to a reduction in value. Such negatively impacted parks may not command the same rent level as comparable parks not facing similar adverse conditions. As a result, the manufactured home owners may pay reduced rents, but the market values of the manufactured homes are not affected since the homes perform as constructed without any decrease in value.

ACCESSORIES

The statutory definition of *manufactured home accessory* includes both portable and permanently installed items. Manufactured home accessories are defined in Health and Safety Code section 18008.5, which provides that accessories include, but are not limited to, awnings, storage cabinets, carports, skirting, heaters, coolers, fences, windbreaks, and porches. Accessories may be real or personal property but, unless they qualify as household furnishings within the context of the law, they are generally subject to local property taxation, whether or not the manufactured home to which they belong is subject to local property taxation. However, pursuant to section 5805, accessories installed on a rented or leased lot with a manufactured home first sold prior to January 1, 1977, are presumed to be subject to the state vehicle license fee. This presumption may be rebutted by evidence that the accessory was not included in the vehicle license fee base for the manufactured home, or was not otherwise subject to the vehicle license fee.

Accessories on licensed manufactured homes sold after January 1, 1977, may be exempted by the county board of supervisors, up to a maximum of $5,000, pursuant to the provisions of section 155.20.

APPRAISAL OF FLOATING HOMES

While vessels are generally regarded as personal property, "floating homes" have been accorded special treatment by the Legislature and are treated as real property. Section 229 provides that

floating homes shall be assessed and valued in the same manner as real property. A floating home, under section 229(c), is defined as a structure that has all of the following characteristics:

1. It is designed and built to be used, or is modified to be used, as a stationary waterborne residential dwelling.
2. It has no mode of power of its own.
3. It is dependent for utilities upon a continuous utility linkage to a power source originating onshore.
4. It has a permanent continuous hookup to a shoreside sewage system.

The statute prescribes that a floating home is not to be assessed as a vessel, but is valued like other real property under the provisions of article XIII A of the California Constitution (Proposition 13).

APPRAISAL OF CONSTRUCTION IN PROGRESS

When real property, or a portion thereof, is being constructed, the assessor must determine the fair market value of the portion of the property that is under construction at each lien date. When the construction is complete, the assessor determines the fair market value of the newly constructed property. The following is a brief discussion of this complex issue. For an expanded discussion, see Chapter 6 of AH 502, *Advanced Appraisal*.

Construction in progress on the lien date is also subject to assessment and must be appraised. Section 71 states, in part:

> New construction in progress on the lien date shall be appraised at its full value on such date and each lien date thereafter until the date of completion, at which time the entire portion of property which is newly constructed shall be reappraised at its full value.

This language is repeated in Property Tax Rule 463(d).

Determining the value of construction in progress sometimes presents a difficult appraisal problem. The same methods and principles that apply when valuing completed improvements are applicable to construction in progress. However, the procedure is usually more difficult due to a lack of market data. The income and sales comparison approaches are of limited use because property under construction is typically not producing any income, and it is difficult to find comparable sales of partially completed projects. For this reason, the cost approach is nearly always used. The cost approach is used to determine the amount of costs in place relative to the partially completed project on the lien date. The total of costs in place on the lien date may be higher or lower than the market value of the new construction in progress on the lien date.

START DATE

The commencement of construction is the date when actual physical activity first occurs on the site. For example, layout of foundations, erection of fencing, site grading, or other physical activity at the site indicate the beginning of construction.

COMPLETION DATE

Since new construction in progress is appraised on each lien date until completed, identifying the date of completion is important. Rule 463.5 defines the date of completion of new construction. In general, the date of completion is the earliest of either the date that an improvement is available for use, the date a certificate of occupancy is issued, or the date that it is occupied.[111]

[111] Further aspects of the appraisal of construction in progress are addressed in Assessors' Handbook Section 502, *Advanced Appraisal*.

APPENDIX A: ADMINISTRATIVE AND LEGAL ASPECTS OF PROPERTY TAX ASSESSMENT

OVERVIEW

PROPERTY TAX BASE

The property tax is a significant general revenue source for local agencies (i.e., counties, cities, and special districts) and school districts. The tax is imposed on the owners of property and is based on property value.[112] Property tax liability is for a fiscal year, or a portion thereof, and property taxes are collected by the county and distributed to local governmental jurisdictions based on a statutory formula.

The property tax is imposed on two major categories of property: real property and tangible personal property. Some of the major types of property that are *not* part of the property tax base are most property owned by government; most private property used for religious, charitable, or educational purposes; household personal property; automobiles and trucks; business inventories; and intangible personal property. [113]

ASSESSMENT ROLL

"Assessment" means placing a value on property for the purpose of property taxation. An assessment roll, as defined in section 109, is the entire listing of all taxable property within the county, including that which is state assessed. Among other things it identifies the property, the owner (if known), and the assessed value of the property. Each year the county assessor prepares two separate rolls: the "regular assessment roll" (sometimes referred to as the "601 roll" because it is discussed in section 601)[114] and the "supplemental assessment roll."

Under section 109, the "secured roll" is that part of the roll containing state assessed property and property on which the taxes are a lien. The remainder of the roll is the "unsecured roll." The "local roll" lists those parts of the secured and unsecured roll containing all property that it is the assessor's duty to assess. The "board roll" is that part of the secured roll containing state assessed property.

Generally, all real property for which title is held by the owner or possessor is on the secured roll. Personal property may also be on the secured roll if its owner also owns real property in the county that can be used to secure the personal property tax liability. The unsecured roll consists of taxable property owned by taxpayers who do not own real property in the county that can be

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[112] However, since the 1978 passage of Proposition 13, discussed later, real property has generally been taxed based on its market value at the time of acquisition or completed new construction, with annual increases for inflation limited to a maximum of 2 percent per year, and not based on its current market value as of each tax year.
[113] The question of what property is taxable is addressed in Chapter 3.
[114] Unless otherwise indicated, all references to "code" in this appendix refer to the Revenue and Taxation Code; all references to "section" or "sections" refer to sections of the Revenue and Taxation Code; and all references to "rule" or "rules" refer to the Property Tax Rules found in Title 18 of the California Code of Regulations.

used to secure payment of the property tax. Most property on the unsecured roll is tangible personal property used by businesses that lease, rather than own, the real property at which they conduct business. In most cases, possessory interests in real property are placed on the unsecured roll if the holder of the possessory interest does not also own other real property in the county. Taxable airplanes and boats are also on the unsecured roll.

The board roll lists all property assessed by the State Board of Equalization (SBE or Board). This roll is prepared by the Board and delivered to the county auditor, who allocates board assessments within the county according to statute. As mentioned above, the board roll is considered part of the secured roll.

Secured property taxes are payable in two installments, the first no later than December 10 and the second no later than April 10. Unsecured property taxes are payable in one installment due no later than August 31. The county tax collector is responsible for the preparation of tax bills and the collection of taxes due.

The supplemental assessment roll lists all property that has undergone a change in ownership or new construction. It is discussed later in this appendix.

Assessment Roll Revisions and Escape Assessments

For a wide variety of reasons, the initial assessment roll inevitably contains errors. Common errors include errors in value judgment, "clerical" (calculation) errors, errors caused by the failure of property owners to report correctly (or to report at all), and various misunderstandings. Such errors result in overassessments, underassessments, misclassifications, assessments to the wrong assessees, assessments assigned to the wrong tax-rate jurisdictions, and numerous other problems that result in incorrect assessments.

In general, California law provides, within specified time limitations, that an erroneous assessment is to be corrected, regardless of the cause of the error and regardless of whether the error resulted in an overassessment or an underassessment. Both the limitation on time (statute of limitations) and the procedure for making a correction vary greatly according to the nature and cause of the error.

Any error that results in an underassessment (or no assessment where there should have been one), regardless of the reason, is an "escape." The first sentence of section 531 makes it clear what is required when an escape has occurred: "If any property belonging on the local roll has escaped assessment, the assessor shall assess the property on discovery at its value on the lien date for the year for which it escaped assessment." Section 861 establishes the same requirement for escaped property subject to assessment by the Board. As stated previously, there are time limitations and procedural differences for various types of escapes, but sections 531 and 861 make it clear that any escape is to be enrolled *unless* the applicable statute of limitations or other specific provision of law prohibits or modifies the assessor's ability to do so.

Errors that result in overassessments must also be corrected. Some of the statutes governing corrections use the word "may" rather than "shall" (e.g., see sections 4831(a) and 4831.5), but others provide that errors resulting in lower values or taxes "shall" be corrected (e.g., sections 51.5, 4831(b), 4985, and 5096). Although legally "shall" is mandatory and "may" is permissive (see section 16), certainly the assessor's obligation to make corrections that result in lower assessments or taxes is equal to the obligation to enroll escapes.

One important difference between escape assessments and corrections that reduce the assessment or tax is that the assessor enrolls escape assessments unilaterally. In most cases, a correction that reduces the assessed value or tax bill requires the concurrence of one or more other county officers, because the taxpayer may be entitled to claim a refund. In the case of a refund of taxes paid, the taxpayer must file a claim for the refund within four years after making the payment or within one year after the mailing of a tax collector's notice of overpayment, whichever is later.

As stated above, the process of correcting an erroneous assessment, whether an escape, a lower assessment, or some other correction, varies greatly according to the circumstances of the change. Assessors' Handbook Section 201, *Assessment Roll Procedures,* contains helpful discussions regarding several types of escape and correction actions. Also see "Taxpayer Reporting of Information" later in this appendix.

PROPERTY TAX RATE

The property tax rate is composed of two parts: (1) the basic, or general, rate; and (2) additional rate(s) levied to retire voter-approved debt.

The basic rate is limited to a maximum of 1 percent. The tax proceeds resulting from the basic rate are general revenues that are apportioned among local jurisdictions (e.g., counties, cities, special districts, and school districts) according to a statutory formula. Local governmental agencies within the counties are permitted to levy additional rates to retire voter-approved debt. The tax proceeds from each additional debt rate are allocated to the local agency that incurred the debt and are earmarked for the payment of principal and interest to retire the debt.

Depending on the number and size of approved debt issues, tax rates may vary from area to area within a county. The SBE maintains a tax-rate area mapping program that assigns a unique tax-rate area number (TRA) to each geographical area in the state with a different distribution of revenues among local taxing jurisdictions. County auditors use TRAs to allocate property tax revenues to the appropriate taxing jurisdictions, and the SBE also uses TRAs to allocate state assessments among the counties.

The tax rate, as described above, applies to locally assessed real property and state assessed property. The California Constitution, article XIII, section 12, provides that the tax rate applicable to the unsecured roll is the prior year's secured roll tax rate.

To determine the amount of tax due, the tax rate is applied to the taxable value of the property (defined as the "assessed value" or "full cash value" per section 51). For example, property with a

taxable value of $200,000 in an area where the total tax rate is 1.1 percent would have a property tax liability of $2,200, computed as follows:

$200,000 assessed value x 0.011 tax rate (1.1%) = $2,200 property tax due

In most cases, the owner of the property is assessed for the property tax. As provided in section 405, the county assessor may assess the owner or the lessee, or may make a joint assessment to both the owner and lessee.

STATE VERSUS LOCAL ASSESSMENT

The assessment function is the joint responsibility of the state's 58 county assessors and the SBE. All taxable property is either locally assessed by county assessors or state assessed by the SBE. County assessors are locally elected officials. Assessors' duties and practices are prescribed by the State Constitution, statutes passed by the Legislature (primarily in the Revenue and Taxation Code or the Government Code), and property tax rules adopted by the State Board of Equalization.

The SBE was established in 1879 by constitutional amendment. Its original purpose was to regulate county assessment practices in order to insure uniform and equitable assessments and to assess the property of railroads. Currently, in addition to its property tax responsibilities, the Board administers a variety of state and local business tax programs. The Board consists of five elected members, four of whom are elected from legislatively defined districts. The fifth member, the State Controller, is elected at large and serves in an *ex officio* capacity.

Role of County Assessors

County assessors are responsible for the assessment of all taxable property within their local jurisdictions, except state assessed property. The assessor's responsibility involves three main objectives: (1) discovering and taking inventory of all taxable property within the county; (2) determining the taxability of each item of property; and (3) valuing and assessing each item of taxable property in accordance with property tax law. Discovering and taking inventory of property and determining its taxability, although difficult processes, are reasonably precise and objective. The third objective, property valuation and assessment, involves detailed analyses and requires the application of considerable knowledge and skill.

Role of the State Board of Equalization

State Assessments and Appeals

Under article XIII, section 19 of the California Constitution, the SBE is responsible for the assessment of property owned or used by specified public utilities (generally regulated telephone, telegraph, electric, and gas companies), the property of railroads, and all intercounty pipelines, canals, flumes, ditches, and aqueducts.[115] The procedures governing such valuation and

[115] See the *State Assessment Manual* for a detailed discussion on state assessment.

assessments are set forth in sections 721 through 868. The values for these state-assessed properties are entered on the Board roll and allocated to the counties on a proportional basis.[116]

The Board also hears appeals of certain property tax matters, including petitions for reassessment of public utilities and railroads (state assessees), appeals on assessments of taxable property owned by local governments outside their boundaries,[117] and appeals by claimants whose property has been denied the welfare exemption by the Board's staff.[118]

Oversight of Local Assessment Practices

In addition to the assessment of state-assessed property, the Board has several duties relating to the local assessment function. As provided in Government Code section 15606, the Board prescribes rules governing all local boards of equalization and assessment appeals, provides training in assessment practices for assessors and their staff, prescribes and enforces the use of assessment forms, and initiates an action in court, if necessary, to compel an assessor to comply with any rule adopted by the Board. These duties, which are aimed at promoting equitable and uniform assessment throughout the state, are carried out through a variety of activities, including the following:

- Property Tax Rules
- Letters To Assessors
- Assessment Practices Surveys
- Assessors' Handbook
- Program Assistance
- Appraiser Training and Certification

Property Tax Rules. The Board prescribes rules and regulations to govern assessors and local boards of equalization (appeals boards). These rules are adopted to interpret and clarify statutes relating to assessment principles and procedures and have the force and effect of law.

Letters To Assessors. The Board issues advisory Letters To Assessors. These letters, which are distributed to all county assessors and to interested parties by subscription, provide uniform information and instruction about particular applications of property tax law and assessment matters.

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[116] The Board performs the entire assessment function—appraisal, assessment, and tax collection—for privately owned railroad cars and harvested timber. The taxes collected from timber owners are redistributed to the counties on a proportional basis; the tax on private railroad cars is the only property tax that is retained by the state.

[117] While the California Constitution provides generally that property owned by government entities is exempt from property taxation, real property owned by local governments outside their boundaries is locally assessable if the property was taxable at the time of acquisition. (Article XIII, section 11.)

[118] In order to qualify for the welfare exemption, the claim must be approved by both the Board and the county assessor.

Assessment Practices Surveys. Under state law, the Board is required to periodically "survey" the assessment practices of each county assessor's office. The purpose of the survey is to (1) determine the adequacy of the procedures and practices the county assessor uses in valuing property, and (2) evaluate the assessor's performance of mandated duties. The Board also conducts "special topic surveys" on assessment practices statewide. These surveys focus on specific subject areas (e.g., "change in ownership" or "assessment appeal procedures") that have a significant impact on local property taxation. They are conducted on an as needed basis.

Assessors' Handbook. The Board publishes the *Assessors' Handbook*, a collection of separately bound manuals on various appraisal and assessment topics for the guidance of assessors and their staffs. The manuals—formally individual "sections" of the *Handbook*—are periodically updated to reflect legislative changes and revisions in recommended appraisal and assessment procedures. This manual, for example, is a particular section of the *Assessors' Handbook*.

Program Assistance. The Board conducts several programs that assist county assessors in the local assessment function. The Board reviews property tax exemptions granted at the county level, and it has a direct role in administering the welfare exemption, which cannot be granted without Board approval. The Board prevents multiple claims for the homeowners' exemption by acting as a statewide clearinghouse for claims, and it performs a similar function for other property tax relief programs. The Legal Entity Ownership Program discovers changes in control or changes in ownership of legal entities, which may require reassessment of property owned by the entities. This information is difficult to acquire at the local level. Finally, the Board prescribes many types of forms used by assessors, including business property statements, exemption claim forms, and change in ownership forms.

Appraiser Training and Certification. Appraisers working for county assessors' offices or the Property Taxes Department of the State Board of Equalization must hold a valid appraiser's certificate issued by the Board. In order to obtain and retain the certificate, appraisers must meet minimum qualifications, pass an examination, and complete a specified number of hours of training per year. The Board conducts training classes and workshops at various sites statewide and monitors appraisers' progress toward fulfilling annual training requirements.

Property tax appraisers meeting the minimum qualifications are issued a temporary certificate, which is valid for no more than one year. Within that time, the appraiser must pass the certification exam given by the Board. Certified property tax appraisers must annually complete 24 hours of training conducted or approved by the Board. After holding a valid appraiser's certificate for at least three years, an appraiser may obtain an advanced appraiser's certificate by meeting specified educational requirements or passing an advanced certification examination. A holder of this certificate is required to complete at least 12 hours of training each year. [119]

[119] Refer to sections 671 through 673 and rules 281 through 283 for certification and training requirements.

LIEN DATE

All taxable property (both state and locally assessed) is assessed annually for property tax purposes as of 12:01 a.m. on January 1, which is called the *lien date*.[120] It is referred to as the lien date because on this date the taxes become a lien against all real property assessed on the secured roll.

TAXPAYER REPORTING OF INFORMATION

The statutes require that any person who acquires real property, a manufactured home, or a controlling interest (more than 50 percent) in a legal entity, or any "original co-owner" who cumulatively transfers more than 50 percent of the legal entity interests, must file a change in ownership statement *within 45 days* of the date of the transfer. (Sections 480 through 480.4.) In most cases, this requirement is satisfied by filing a preliminary change in ownership report (PCOR) *concurrently with the recordation* of the deed. Both the change in ownership statement and the PCOR inform the assessor of the property, date, and persons involved in a change in ownership and whether or not the property is subject to reappraisal. Similar provisions in sections 480.7 and 487 require that a life insurance company that has established a separate account in connection with a pension plans must file a change in ownership statement showing transfers of real property to or from that account. Penalties are applicable for failure to report any transfers resulting in a change in ownership. (Sections 480.7 and 482.)

With respect to reporting personal property, section 441 requires that each person/legal entity owning taxable personal property costing $100,000 or more shall file with the assessor a signed *property statement* between the lien date and 5 p.m. on April 1. Persons or entities that do not meet the $100,000 threshold are nevertheless required to file upon request of the assessor. A penalty of 10 percent of the assessed value of the unreported property may be imposed for failure to file timely. If, after written request any person fails to provide the information required, the assessor shall estimate the value of the property and "promptly" assess the property.

TAXPAYER APPEALS OF PROPERTY VALUATION

Property owners may appeal assessments[121] appearing on the regular assessment roll by filing an application for change in assessment with the county appeals board (either the board of supervisors sitting as a county board of equalization or an assessment appeals board appointed by the board of supervisors to replace the county board of equalization) *between July 2 and September 15*.[122] Assessments made outside the regular assessment period (e.g., supplemental assessments and escape assessments) may also be appealed according to statutory provisions found in section 1603 and following. (For appeals of base year values, also see section 80.)

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[120] Section 2192 of the Revenue and Taxation Code.

[121] See the *Assessment Appeals Manual* for detailed discussion of assessment appeals.

[122] If September 15 falls on Saturday, Sunday, or a legal holiday, an application that is mailed and postmarked on the next business day shall be deemed to have been filed within "the time period between July 2 and September 15." Additionally, effective January 1, 2002, the deadline is extended from September 15 to November 30 for property on the secured roll if the assessee did not receive notice prior to August 1 of the same year.

When the taxpayer challenges an assessment, there is frequently some discussion informally with the assessor's office as to how the assessment was determined. The assessor and the taxpayer may exchange information about the value or characteristics of the property. Occasionally, in becoming aware of new facts affecting the value of the property, the assessor and the taxpayer may agree to the same amount and file a written stipulation with the board. (Section 1603(c).)[123]

The first formal level of appeal is to the board of supervisors sitting as a county board of equalization or to an assessment appeals board if the county has created one or more of these boards. Counties may also use hearing officers for some types of appeals. The hearing is administrative in nature, so the taxpayer's use of legal counsel is optional.

Generally, the property owner has the burden of proving that the assessor has improperly valued the property. However, the burden of proof falls on the assessor in the case of an appeal concerning an owner-occupied single-family dwelling or any appeal of an escape assessment. In a case where real property transferred ownership, section 110 and rule 2 provide that the purchase price is rebuttably presumed to be the correct value as of the date of the transfer. The burden of proof falls on the party seeking to overcome that presumption.[124]

If the appeal is denied, the taxpayer has recourse to the courts, but only under certain circumstances. These include arbitrariness, lack of due process, abuse of discretion, failure to follow standards prescribed by law (e.g., using an erroneous method of valuation), or other questions of law. The assessor may appeal to court for the same reasons as the taxpayer. In either case, the court will not receive new evidence of value and will only review the record of the hearing before the county board.

In the case of state-assessed properties, assessees appeal to the State Board of Equalization. If the appeal is denied, the assessee is entitled to *trial de novo* in the superior court. (In a *trial de novo*, new evidence may be heard, and the court hears the case based on all available information, not just that contained in the prior administrative record.)

PROPERTY TAX EXEMPTIONS

The State Constitution provides for a variety of exemptions from the property tax. Some of the exemptions are required by the Constitution. Others are not specifically required but the Constitution provides that the Legislature may, by statute, provide for the exemption. Some exemptions include the entire property; others provide for partial relief. In total, there are over 100 exemptions from property tax. About 30 of them require claims to be filed or the exemption is waived.

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[123] Appeals boards are not required to accept stipulations, so a stipulation must contain adequate reasons for an agreed-upon value.

[124] This presumption does not apply to a sale of a possessory interest. In the case of an appeal of a cable television possessory interest where the assessor values the possessory interest based on something other than a portion of the franchise fee, neither side has a presumption of correctness.

The Legislature has authority to exempt any kind of personal property as prescribed by statute, but it cannot exempt real property without specific Constitutional authority. Exemptions are not a creation of article XIII A (Proposition 13) but are provided under article XIII of the Constitution.

In regard to real property, article XIII, section 3 lists the various types of exempt property. Section 4 describes the type of property that the Legislature may exempt from property taxation in whole or in part and includes the welfare exemption, and section 6 provides that the failure to claim an exemption in the manner prescribed by law is deemed a waiver of the exemption. Article XIII, section 7, allows the Legislature, with a two-thirds vote, to authorize county boards of supervisors to exempt real property having a full value so low that, if not exempt, the total taxes and applicable subventions on the property would amount to less than the cost of assessing and collecting them.[125]

THE ASSESSMENT PROCESS

The "assessment process" describes the functions required in property assessment. Although the following is primarily directed at local assessment, much of it applies to state assessment as well. A review of the assessment process presents a good overview of the assessment activities within an assessor's office. The assessment process comprises the following functions:

- Property Discovery
- Property Identification and Situs
- Property Classification
- Data Collection and Analysis
- Property Valuation
- Preparation and Certification of the Assessment Roll
- Notification of Assessment
- Appeals Management

Property Discovery. This function involves finding all taxable property in the jurisdiction. For land, buildings, and other things attached to land (real property), this requires a mapping system and, generally, on-site verification of location. The discovery of movable items (personal property) is accomplished by a system of taxpayer self-reporting as described above and is supported by an audit program. The discovery phase also includes obtaining an accurate description of the taxable property.

Property Identification and Situs. Real property items are identified by a parcel identification system keyed to assessor's maps. Personal property is identified by some type of account identification system. Situs refers to physical location in the case of real property and taxable location in the case of personal property.

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[125] The subject of exemptions is briefly discussed in Chapter 3.

Property Classification. The assessed property must be classified according to type. Common categories include land, improvements, fixtures, personal property, and exempt property. This list is not all-inclusive. The property classification may have a bearing on the manner in which property is assessed or taxed.

Data Collection and Analysis. This phase involves the collection and analysis of the economic data required to value the property. General, comparative, and specific data are collected.

Property Valuation. In this phase, generally accepted methods of valuation are used in conjunction with the data obtained to estimate the taxable value of the property. The valuation becomes the basis for the assessment.

Preparation and Certification of the Assessment Roll. As previously discussed, the assessment roll lists the taxable value of all taxable property in a county. The specific content of the roll is prescribed by statute and Board regulation. The assessor is required to complete and deliver the local roll to the county auditor on or before July 1 of each year.

Notification. On or prior to the completion of the assessment roll, the assessor must provide notification to property owners of their assessments in a manner prescribed by law. The assessor is always required to notify owners whose real property value has increased for reasons other than an increase caused by the annual inflation factor. Generally, the law permits but does not require assessors to notify owners if there has been a decrease in the assessment or no change to the assessment.

Appeals Management. As previously discussed, property owners have the right to appeal their assessments before a local appeals or equalization board. An important part of the assessor's office workload following enrollment of the assessment is the management of the appeals function.

FOUNDATION OF PROPERTY TAX LAW

The foundation of property tax law is found in the California Constitution, state statutes, property tax rules, judicial decisions, and other sources. These are discussed below.

CALIFORNIA CONSTITUTION

The basis for assessment of all real and personal property in California is the California Constitution. Specifically, all property tax assessments are established by the provisions of either article XIII or article XIII A (the constitutional article adopted following the passage of Proposition 13). In one form or another, article XIII, section 1, authorizing the assessment of property "in proportion to its full value unless otherwise provided by this constitution or the laws of the United States," has been in existence for more than 100 years. Article XIII A (Proposition 13), adopted in 1978, overlays an additional system of assessment, and to that extent, it has overridden article XIII, section 1. However, personal property continues to be governed by article XIII, section 1. Not subject to the California Constitution are federal lands and all property

owned by the United States, including certain Indian lands and personal property, which are immune from taxation by states and counties unless authorized by Congress.

STATUTES

The vast majority of the Legislature's enactments with respect to ad valorem assessment are found in the Revenue and Taxation Code. Where there is an apparent inconsistency or contradiction between a statute enacted by the Legislature and a provision of the Constitution, the SBE and the county assessor have no authority to refuse to apply or enforce the statute. Under article III, section 3.5 of the Constitution, an administrative agency created by the California Constitution or by an initiative has no power to declare a statute unconstitutional or refuse to enforce it *unless* an appellate court has made a determination that such statute is unconstitutional. Although a county assessor is also considered an "administrative agency," section 538 grants special authority to assessors to bring suit if the assessor believes a statute or a rule to be unconstitutional or invalid.

PROPERTY TAX RULES

Title 18 of the California Code of Regulations embodies the Property Tax Rules, which are formally promulgated by the SBE for the purpose of interpreting and implementing the statutes. Numerous appellate courts have held that these rules are more than mere "guidelines" and have the force of law on all parties, both taxpayers and assessors.

JUDICIAL DECISIONS

Judicial precedents under both article XIII and article XIII A have shaped the course of California's property tax system. For example, in *DeLuz Homes, Inc.* v. *County of San Diego* (1955) 45 Cal.2d 546, the court upheld both the concept and the valuation of possessory interests, stating that possessory interests in tax exempt land or improvements are taxable real property and must be assessed at full cash value. In the case of *Amador Valley Joint Union High School Dist.* v. *State Board of Equalization* (1978) 22 Cal.3d 208, the court determined that Proposition 13 was constitutional and not a violation of equal protection. As another example, in *Title Insurance & Trust Co.* v. *County of Riverside* (1989) 48 Cal.3d 84, the court held that if in a corporate merger or reorganization one entity *indirectly* obtains control over another (through the purchase or transfer of stock), there is a change in ownership as to the real property owned by the corporation which obtained indirect control.

In some instances, the Legislature has responded to appellate or Supreme Court decisions by amending property tax statutes in major respects, such as excluding from change in ownership the dissolution of a partnership by means of a buy-out by the majority partner under section 64(a), reversing the consequences of *Zapara* v. *County of Orange* (1994) 26 Cal.App.4th 464.

OTHER

While several Board-generated documents and publications provide advice regarding the application of property tax law and assessment (the *Assessors' Handbook*, *Letters To Assessors*, and *Assessment Practices Surveys* described previously), none actually have the authority of law.

They are distributed to all county assessors and other interested parties in order to provide guidance about particular aspects of property tax assessment and to promote uniform assessment practices consistent with property tax law. While courts have assigned varying degrees of importance to such documents ("entitled to great weight" as opposed to "not persuasive"), they are strictly advisory and are not binding on taxpayers or assessors.

ASSESSMENT PRE- AND POST-PROPOSITION 13

In June 1978, when California voters approved Proposition 13 (placed into law by article XIII A amending the California Constitution and subsequent implementing statutes and rules), California property taxation was revolutionized by: (1) limiting the property tax rate to 1 percent plus additional rates necessary to retire voter-approved bonded indebtedness; (2) placing explicit limitations on the power of government to impose additional property taxes; and (3) significantly changing the method of property assessment.

Prior to Proposition 13, annual assessments for both real property and personal property were based on current market value. As a practical matter, fiscal and staffing constraints prevented assessors from physically revaluing each item of property in their respective counties every single year, with the result that reappraisals were usually conducted on a cyclical basis. Typically, these cycles ranged in duration from three to seven years. Between physical reappraisals, assessors would often apply interim value increases based on trending factors. This system of assessment ensured that all property—subject to the limitations of cyclical appraisal programs—was assessed based on its current market value.

Under the law implementing Proposition 13, most locally-assessed real property is now subject to a set of assessment rules based on its *market value at the date of acquisition*. Several important components of this system are described below:

- Proposition 13 first required property assessments to be "rolled back" to the 1975-76 level for the 1978-79 fiscal year. Properties that have not sold or undergone new construction since February 1975 are said to have a 1975 *base year value*. The base year value is the current market value (or "full cash value") of real property in 1975-76, or in any subsequent year based upon a change in ownership or new construction. (Sections 50 through 51.5, and 110.1.)
- Each property's base year value must be adjusted each year to reflect inflation as measured by the California Consumer Price Index, but an upward adjustment cannot exceed 2 percent. This process continues until the property changes ownership or undergoes new construction. The value that reflects the annual inflation indexing is known as the *adjusted,* or *factored, base year value*. (Section 51.) Each year, the adjusted base year value is the maximum assessable amount for the property for that year.
- When a change in ownership occurs, real property is assessed to its current market value as of the date of the change in ownership. (Sections 60-61.) Newly constructed property is also assessed at its current market value as of its date of completion. (Unfinished new

construction is assessed based on its market value on the January 1st date.) (Sections 70-71.) *Acquisition value assessment* refers to the process of basing the assessment on the value of the property at change in ownership or completed new construction. The assessment at the time of change in ownership or new construction becomes the property's new base year value, which is subject to the annual inflation adjustment described above.

- If a fractional change in ownership occurs, the portion that changes ownership is given a new base year value based upon its current market value as of the date of the change in ownership and the portion that did not change ownership retains its existing adjusted base year value. Analogously, if new construction occurs on only a portion of a property (e.g., the addition of a bedroom), the newly constructed portion is given its own base year value based upon its current market value, and the pre-existing portion retains the old adjusted base year value. Thus, a property assessment can contain multiple base year values, based upon prior fractional ownership changes or partial new construction, until such time as the entire property interest changes ownership.
- Property assessments are reviewed each year for a decline in value. If the current market value of a property is below its adjusted base year value, the property is temporarily reassessed to reflect the lower value, that is, current market value. (Section 51(a).) This type of reduction is frequently referred to by the original proposition number approved by the voters, or a "Proposition 8" (or Prop 8) adjustment. At some future year, when the property's current market value exceeds its adjusted base year value, the adjusted base year value is restored to the assessment roll.

Not all property is subject to article XIII A (Proposition 13). Locally assessed personal property and state assessed property are not subject to Proposition 13 (article XIII A).[126] These two categories of property are assessed at current market value each year, as of the lien date, by county assessors and the SBE, respectively.

Thus, the only category of property generally subject to the provisions of article XIII A, although it includes the major portion of the total assessed value in the state, is locally assessed real property (including fixtures). Within this category there are several classes of property not subject to article XIII A provisions. These include "restricted value" properties and taxable government lands.[127]

SOME IMPORTANT ASSESSMENT PROVISIONS

The following sections, building on the framework outlined above, discuss several significant assessment provisions under article XIII A.

[126] The appraisal and assessment of personal property is addressed in Chapter 7.
[127] Restricted value properties and taxable government owned lands are discussed in Chapter 3.

EXCLUSIONS FROM REASSESSMENT UPON CHANGE IN OWNERSHIP OR NEW CONSTRUCTION

Constitutional amendments to Proposition 13 and various statutory interpretations have permitted several exclusions from the provisions requiring the reassessment of locally assessed real property to current market value upon a change in ownership or new construction. Some significant exclusions are:

Interspousal Exclusion. According to section 63, any transfer between spouses during marriage or transfers between former spouses after marriage in connection with a property settlement agreement or dissolution are excluded from change in ownership provisions. No claim form is required.

Parent/Child and Grandparent/Grandchild Exclusion. Under section 63.1, transfers from parents of their principle residence and up to $1 million (taxable value) of other property to their children (and vice versa) may be excluded from change in ownership reassessment, providing a claim is filed and certain requirements are met. In 1996, a similar exclusion was enacted for transfers of property occurring on or after March 27, 1996, from a grandparent to a grandchild under certain limiting conditions. If a claim is not timely filed, the exclusion is available prospectively only when the claim is filed.

Trust Exclusion. Under section 62 (d), transfers of real property or interests in legal entities into a revocable trust or into an irrevocable trust in which the grantor/transferor is the present beneficiary are excluded from change in ownership. It is necessary to look through the trust to determine the beneficial owners of the property or legal entity transferred.

Replacement Property for That Taken by Eminent Domain. Excluded from change in ownership and reappraisal is the acquisition of comparable replacement property made necessary due to a taking by eminent domain, public entity acquisition, or judgment of inverse condemnation. A claim must be timely filed. (Section 68.)

Replacement Residences for Senior Citizens or Disabled Persons. Under section 69.5, senior citizens may transfer the adjusted base year value of an original principal residence to a replacement principal residence if the replacement is of equal or lesser current market value and is located in the same county, or between counties if the county where the replacement home is located has adopted an ordinance permitting the transfer. Severely and permanently disabled persons meeting specified requirements may also transfer the base year value of an original principal residence to a replacement dwelling of equal or lesser current market value under the same provisions. A claim form is required and the claim must be timely filed.

Property Acquired or Constructed to Replace Property Destroyed in a Disaster. Owners of property that is substantially damaged or destroyed by a disaster, as declared by the Governor, may transfer the base year value of such property to comparable property within the same county under conditions specified in section 69. Alternatively, under the conditions prescribed in section 69.3, an intercounty transfer of the base year value is allowed if the county where the

replacement home is located has adopted an ordinance permitting the transfer. A claim form must be timely filed.

Proportional Interest Transfers. Under section 62(a)(2), any transfer between an individual and a legal entity or between legal entities that results solely in a change in the method of holding title to the real property, and in which the proportional ownership interests of the transferors and transferees remain exactly the same, is excluded from change in ownership and reappraisal. It is necessary to look through the legal entity to determine the proportionality of ownership interests and whether the exclusion applies; a change in ownership statement is required.

Legal Entity Interest Transfers. Under section 64(a), the purchase or transfer of ownership interests in legal entities, such as corporate stock, partnership or LLC interests, does not constitute a transfer of the real property owned by the legal entity, unless there is a change in control under section 64(c) or a change in ownership under section 64(d).

Other. Exclusions from market value assessment as a result of new construction include the following: (1) additions of fire sprinkler systems (section 74); (2) modifications to make an existing residence or structure more accessible to a severely and permanently disabled person (sections 74.3 and 74.6); and (3) specified seismic retrofitting and earthquake hazard mitigation features applied to existing buildings (section 74).

DECLINE IN VALUE APPRAISALS

Proposition 8, passed in November 1978, amended article XIII A to provide for declines in value. As a result, section 51 requires the assessor to annually enroll either: (1) a property's base year value factored for inflation; or (2) its market value as of the lien date (taking into account any factors causing a decline in value), whichever is lower.

When a property is assessed at its current market value due to a decline in value, the resulting assessment is commonly referred to as a "Prop 8" value or assessment. Prop 8 reductions in value are *temporary* reductions recognizing that the current market value of a property has fallen below its factored base year value. Once a Prop 8 value has been enrolled, a property's value must be reviewed each following lien date to determine whether its then current market value is less than its factored base year value. When and if the market value of the Prop 8 property increases above its factored base year value on a subsequent lien date, the assessor must again enroll its factored base year value.

Unlike adjusted base year values, which may increase no more than 2 percent in any year, Prop 8 values can vary widely from year to year as the market fluctuates. However, in no case may a Prop 8 value higher than a property's factored base year value be enrolled.

Some declines in value are treated differently than under Prop 8. If a property is damaged or destroyed by a *misfortune or calamity* and the county in which it is located has adopted a disaster ordinance pursuant to section 170, the owner may qualify for a reduction in the assessment that differs significantly from a Prop 8 reduction. First, such a reduction is effective immediately as of the date a calamity occurs, instead of on the following lien date as in a Prop 8 reduction. Second,

calamity reductions result in a lower assessment only during the time period between the date of damage and completion of repair. When the repair is complete, the property's factored base year value is restored to the assessment roll (however, items added during repair and not a part of the original property may qualify as new construction and result in additional assessments).

If a property was being assessed under Prop 8 when it suffered damage and was then granted additional calamity relief under section 170, the assessor must carefully review the value of the property at the completion of repair to determine whether its factored base year value or Prop 8 market value should be enrolled.

SUPPLEMENTAL ASSESSMENT ROLL

During the first five years after the implementation of Proposition 13, some property owners were able to delay the added property tax liability arising from a change in ownership or new construction. This occurred because of the continuation of pre-Proposition 13 rules establishing tax liability for the fiscal year (July 1 to June 30) based on the taxable value of the property as of the preceding March 1 lien date. (Effective for the 1997 assessment year, the lien date was changed from March 1 to January 1.)

Prior to July 1, 1983, the law provided that when property was assessed due to change in ownership or new construction, the additional value was not subject to tax until the next fiscal year beginning *after* the next March 1. Under this system, new value could escape taxation for a period of from 4 to 15 months. For example:

- An ownership change in February 1980 was not reflected in higher taxes until the 1980-81 fiscal year, beginning July 1, 1980, 4 months later.
- An ownership change on March 2, 1980, was not reflected in higher taxes until the 1981-82 fiscal year, beginning July 1, 1981, 15 months later.
- An ownership change in October 1980 was not reflected in higher taxes until the 1981-82 fiscal year, beginning July 1, 1981, 8 months later.

With the Legislature's enactment, effective July 1, 1983, of supplemental assessment provisions, property reassessed due to a change in ownership or new construction is now subject to tax immediately (as of the date of change in ownership or completion of new construction) by placing the new taxable value on the supplemental assessment roll. (Sections 75 and others.) The supplemental roll applies only to locally assessed real property and manufactured homes.

Under the supplemental roll system, the increase or the decrease in assessed value resulting from a change in ownership or new construction is reflected in a prorated assessment (the *supplemental assessment*) that covers the portion of the fiscal year remaining after the date of the change in ownership or completed new construction. The supplemental assessment statutes apply to any property subject to article XIII A that has undergone a change in ownership or completed new construction since July 1, 1983.

For changes in ownership or completed new construction occurring between January 1 and May 31, two supplemental assessments are issued. The first covers the portion of the current fiscal year remaining after the assessable event; the second covers the ensuing fiscal year in its entirety.

Supplemental assessments do not affect exemptions for which the assessee is otherwise eligible. If granted, the exemption is applied to the amount of the supplemental assessment.

- Effective January 1, 2001, section 75.11(d) requires assessors to enroll all supplemental assessments: 1) on or before the fourth July 1 following the July 1 of the assessment year in which either a change in ownership statement under sections 480 - 480.2 was filed or preliminary change in ownership report under section 480.3 was filed or new construction was completed, 2) on or before the sixth July 1 following the July 1 of the assessment year in which either a change in ownership statement under sections 480 - 480.2 was filed or a preliminary change in ownership report was filed, or new construction was completed if the section 504 penalty was added, or 3) on or before the eighth July 1 following the July 1 of the assessment year in which the event occurred if the change in ownership or change in control was unrecorded and a change in ownership statement required by section 480 or preliminary change in ownership report, as required by section 480.3, was not timely filed. Effective January 1, 2002, the time limit for change in ownership statement or completion of new construction to which the penalty in section 504 was added is changed from six years to eight years. However, there is no limitations period on enrolling supplemental assessments if the penalty under section 503 is added.

APPENDIX B: COMMON MEASUREMENTS USED IN APPRAISAL

Land Measurements-Linear

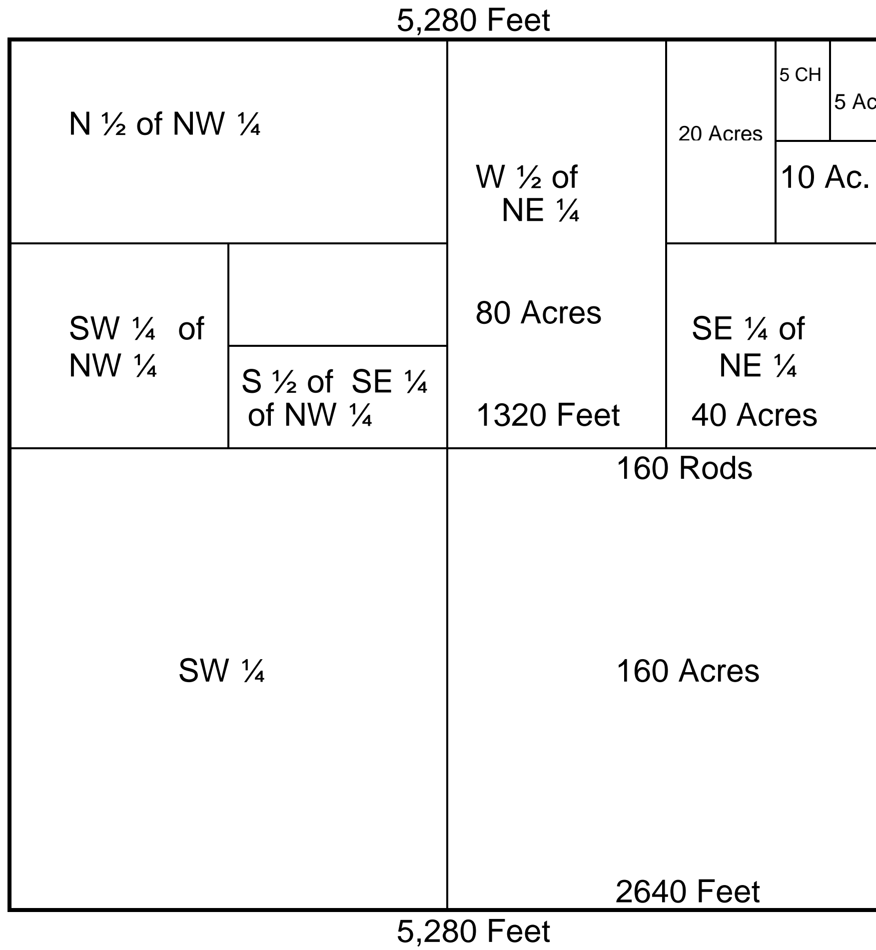
1 foot	=	12 inches
1 yard	=	3 feet
1 mile	=	1,760 yards
1 mile	=	5,280 feet
1 link	=	7.92 inches
1 rod	=	25 links
1 rod	=	16.5 feet
1 chain	=	4 rods
1 chain	=	100 links
1 chain	=	66 feet
1 furlong	=	10 chains
1 furlong	=	660 feet
1 furlong	=	1/8 mile
1 mile	=	80 chains
1 mile	=	320 rods
1 league	=	3 miles
1 league (Spanish)	=	2.6 miles
1 vara	=	33 inches
1 vara	=	2.75 feet

Land Measurements-Area

1 square foot	=	144 square inches
1 square yard	=	9 square feet
1 acre	=	43,560 square feet
1 acre	=	4,840 square yards
1 acre	=	160 square rods
1 acre	=	10 square chains
1 square mile	=	640 acres
1 square mile	=	1 section
36 sections	=	1 township

Depiction of a Section

1 section = 1 square mile



GLOSSARY OF TERMS

Term	Definition
Annuity	A periodic series of obligatory payments; an annuity can be level, increasing, decreasing, or a combination thereof.
Annuity Factor	In yield capitalization, the number, usually obtained from financial tables, that is multiplied by an income amount to produce an estimate of present value.
Appraisal Unit	The unit that people in the market typically buy and sell.
Appreciation	The increase in property value resulting from an excess of demand for a property relative to its supply.
Assemblage	The combining of two or more parcels, usually but not necessarily contiguous, into one ownership or use.
Assessed Value	The taxable value of a property against which the tax rate is applied.
Assessment Roll	A listing of all taxable property within a county. It identifies, at a minimum: (1) the property (usually by assessor's parcel number); (2) the tax-rate area where the property is located; (3) the name (if known) and mailing address of the assessee; (4) the assessed value of the property, including separate assessed values for land, improvements, and personal property; (5) penalties (if any); and (6) the amount (if any) of specified exemptions (e.g., Homeowners', Church, Welfare, etc.). Distinct assessment rolls include the locally-assessed secured and unsecured regular assessment rolls, the locally-assessed supplemental assessment roll, and the state-assessed roll (which is added to the locally-assessed secured roll).
Band of Investment	A technique in which the capitalization rates attributable to the components of a capital investment are weighted and combined to derive a weighted-average rate attributable to the total investment.
Base Year Value	In accordance with section 110.1, a property's base year value is its fair market value as of either the 1975 lien date or the date the property was last purchased, newly constructed, or underwent a change in ownership after the 1975 lien date.
Capitalization	Any method of converting expected future benefits into an indicator of present value; the discounting of projected income to a present value.
Capitalization Rate	Any rate used to convert income into an indicator of value; a ratio that expresses a relationship between income and value.
Change in Ownership	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.

Term	Definition
Comparative Sales Approach	An approach to value by reference to sale prices of the subject property or comparable properties; under rule 4, the preferred approach when reliable market data are available.
Compound Interest	Interest on the sum of principal and the accrued interest, combined at regular intervals; interest on interest.
Contract Rent	The actual amount of rent a property is earning as specified in a lease; the existing rent on property as distinguished from rent that could be expected if the property were available for rent on the open market.
Cost	The expenditure required to develop and construct an improvement or acquire personal property.
Cost Approach	A value approach using the following procedures to derive a value indicator: (1) estimate the current cost to reproduce or replace an existing structure without untimely delays; (2) deduct for all accrued depreciation; and (3) add the estimated land value and an amount to compensate for entrepreneurial profit (if present).
Cost-Estimating Methods	The estimation of replacement or reproduction cost. Four methods are described below: (1) *Quantity Survey Method.* Under this method, all costs of each piece of material and all labor are estimated and summed; this method accounts for the quantity and quality of all the agents of production necessary to develop and construct an improvement. (2) *Square Foot Method.* This method uses the known costs of similar buildings, adjusted for physical differences and market conditions. The costs are estimated in terms of dollars per unit, such as $100 per square foot; costs per unit for properties of equal utility are often obtained from data compiled and published by cost-estimating firms. Also known as the Comparative Unit method. The Assessors' Standard Classification System is used in conjunction with square foot cost tables to produce a cost estimate using the square foot method. (3) *Unit-In-Place Method.* This method adds together the unit cost of each component of an improvement, such as the cost of a foundation, a wall, or a roof; costs for walls and foundations are usually estimated per linear foot and are often obtained from data compiled and published by cost-estimating firms. (4) *Trended Historical Cost.* Under this method, an improvement's historical cost is adjusted (factored forward) to the current price level using trending tables.

Term	Definition
Depreciation	A decrease in utility resulting in a loss in property value; the difference between estimated replacement or reproduction cost new as of a given date and market value as of the same date. There are three principal categories of depreciation, described below: (1) *Physical Deterioration.* The loss in utility and value due to some physical deterioration in the property; considered curable if the cost to cure it is equal to or less than the value added by curing it. (2) *Functional Obsolescence.* The loss in utility and value due to changes in the desirability of the property; attributable to changes in tastes and style or the result of a poor original design. Functional obsolescence is curable if the cost to cure it is equal to or less than the value added by curing it. (3) *External (or Economic) Obsolescence.* The loss in utility and value due to an incurable defect caused by external negative influences outside the property itself; results from the immobility of real property.
Direct Capitalization	A capitalization method used to convert a single year's income expectancy into an indicator of value, either by dividing the income estimate by an appropriate rate or by multiplying the income estimate by an appropriate factor.
Direct Costs	Expenditures required for the labor and materials necessary to develop and construct an improvement; sometimes referred to as "hard costs."
Discounted Cash Flow (DCF) Method	A capitalization method in which a discount rate is applied to a series of projected income payments, including the reversion, in order to arrive at an estimate of present value (i.e., current market value). The DCF method can be applied with any yield capitalization technique.
Discount Rate	A selected yield rate used to convert expected future payments into an estimate of present value.
Economic Life	The period of time over which improvements to real property contribute to property value.
Economic Rent	The amount of rental income that could be expected from a property if available for rent on the open market, as indicated by the prevailing rental rates for comparable properties under similar terms and conditions; economic rent is distinguished from contract rent, which is the actual rental income for the subject property as specified in a lease; economic rent is also referred to as market rent.
Effective Age	The age indicated by the condition and utility of the property.
Effective Gross Income	The estimated potential gross income less allowances for vacancy and collection losses.

Term	Definition
Equity Dividend	A single year's cash flow after debt service but before income taxes (i.e., a single year's net income before recapture (NIBR) less debt service).
Equity Capitalization Rate	A rate that reflects the relationship between the equity dividend and the equity investment (i.e., a single year's net income before recapture less debt service divided by the equity investment); a rate used to convert the equity dividend into an indicator of equity value; also known as the equity dividend rate, the cash on cash rate or the cash flow rate.
Expense Ratio	The ratio of total expenses, excluding debt service, to either potential or effective gross income
Factor	One of two or more numbers that when multiplied together produce a third number; a multiplier. A capitalization factor is the reciprocal of a capitalization rate.
Fee Simple Estate	Absolute ownership unencumbered by any other interest or estate, subject only to the limitations of eminent domain, escheat, police power, and taxation.
Fixture	An item of tangible property, the nature of which was originally personal property, but which is classified as real property for property tax purposes because it is physically or constructively annexed to real property with the intent that it remain annexed indefinitely.
Going Concern Value	Generally, the total value of an operating business enterprise. It includes the value of the real property, tangible personal property (e.g., machinery and equipment), labor, the marketing operation, and intangible assets and rights. It includes the incremental value of the business concern, which is distinct from the value of the real property (See also footnote in Chapter 1, "Other Types of Value," under the definition there.) This subject is addressed in depth in Assessors' Handbook Section 502, *Advanced Appraisal*.
Gross Income Multiplier	The relationship between sale price (or value) and gross income, expressed as a factor; used to estimate value as a multiple of income. Gross income is usually (though not always) expressed in annual terms, and includes income to the property from all sources; in an apartment property, for example, the gross income could be the sum of living unit rent, parking space rent, vending machine income, and laundry facility income.

Term	Definition
Gross Rent Multiplier	The relationship between sale price (or value) and gross rent, expressed as a factor; used to estimate value as a multiple of income. Gross rent is usually (though not always) expressed in annual terms, and includes the income to the property derived from the principal improvements only. The gross rent for an apartment property, for example, is from living units only and excludes income from parking space rent, vending machine income and laundry facility income.
Highest and Best Use	The most profitable use of a property at the time of the appraisal; that available use and program of future utilization that produces the highest present land value; must be legal, physically possible, financially feasible, and maximally profitable; see text for the distinction between highest and best use as though vacant and highest and best use as improved.
Historical Cost	The total cost of a property when it was originally constructed.
Improvements	All buildings, structures, fixtures, and fences erected on or affixed to the land; all fruit, nut bearing, ornamental trees and vines, not of natural growth, and not exempt form taxation, except date palms under eight years of age; see text for statutory definition.
Income Approach	Any method of converting an income stream or a series of future income payments into an indicator of present value.
Income Rate (R_o, or R_E)	A rate that expresses the relationship between one year's income and the corresponding total value of a property; or, in the case of R_E, with the value of only the equity interest.
Indirect Costs	The outlay for items, other than labor and materials, required to develop and construct an improvement; includes such costs as legal fees, property taxes, construction financing, administrative expenses, appraisal fees, and lease-up expenses; sometimes referred to as "soft costs."
Interest Rate	The rate of return on debt capital; the price paid for borrowing money.
Investment Value	The specific value of property to a particular investor, based upon individual investment requirements, as distinguished from the concept of market value.
Leaseback	A transaction in which an investor purchases property and leases it back to the seller, generally under lease terms and conditions that were negotiated at the time of the sale.
Leased Fee Interest or Estate	The lessor's interest in property; an ownership interest held by a landlord with the right of use and occupancy conveyed by lease to others; the right to receive rent stipulated in the lease and to receive the property (the reversionary right) at the end of the lease term.

Term	Definition
Leasehold	The lessee's interest in property; the right to use and occupy real property during the term of a lease, subject to any contractual restrictions.
Lessee	One who has the right to use or occupy property under a lease agreement; a tenant.
Lessor	One who conveys the right to use and occupy property under a lease agreement; a landlord.
Lien date	All taxable property (both state and locally assessed) is assessed annually for property tax purposes as of 12:01 a.m. on January 1, which is called the lien date. It is referred to as the lien date because on this date the taxes become a lien against all real property assessed on the secured roll.
Loan-to-Value Ratio	The ratio between the mortgage amount and the value of the property pledged as security for the debt; usually expressed as a percentage.
Market Rent	The amount of rental income that could be expected from a property if available for rent on the open market, indicated by the prevailing rental rates for comparable properties under similar terms and conditions; distinguished from contract rent, which is the actual rental for the subject property as specified in a lease; also referred to as economic rent.
Mortgage Constant	The capitalization rate for debt; the ratio of the annual debt service to the principal amount of the mortgage loan; the total annual amount required to pay off an amortizing loan with level monthly payments, expressed as a percentage of the original loan amount.
Net Income Before Recapture and Taxes (NIBR&T)	The annual net income remaining after deducting all operating expenses but before deducting other charges such as recapture, debt service, and property taxes. For property tax appraisal purposes, NIBR&T is capitalized into an indicator of value using various income capitalization techniques.
Net Lease	A lease where the lessee pays not only for the use of the property, but also for stipulated additional charges such as property taxes, insurance, and maintenance.
New Construction	Any addition to real property, whether land or improvements (including fixtures) since the last lien date; any alteration of land or improvements (including fixtures) since the last lien date that constitutes a major rehabilitation thereof or which converts the property to a different use.
Operating Expenses	The periodic expenditures necessary to maintain the real property and continue production of the effective gross income, assuming prudent and competent management; sometimes referred to as "allowable expenses."

Term	Definition
Overall Rate (R_o)	The relationship between the anticipated net income before deducting for recapture (NIBR) and the sale price; the rate implies the investor's perception of both return on and recapture of the investment.
Percent Good	The complement of depreciation; if a property is 20 percent depreciated, its percent good is 80 percent; percent good refers to the portion of benefits remaining in an asset compared to the total benefits when new.
Personal Property	Personal property includes all property except real property.
Plottage	An increment of value that results when two or more sites are assembled under single ownership, producing greater utility.
Potential Gross Income	The total income of a property before deducting vacancy and collection losses or operating expenses.
Principal	A capital sum; a payment for reduction of the capital borrowed as distinguished from the payment of interest.
Projection Period	The holding period; a period of time over which net income is projected for valuation purposes; a presumed period of investment in property.
Property	Property includes all matters and things—real, personal, and mixed—that are capable of private ownership.
Real Property	The possession of, claim to, ownership of, or right to the possession of land; all mines, minerals, and quarries in the land; all standing timber whether or not belonging to the owner of the land, and all rights and privileges appertaining thereto; and improvements; in California property tax law, the term is synonymous with "real estate."
Recapture	The return of invested capital; in real estate investments, capital may be returned gradually as part of the annual income; it may be recaptured all or in part through resale of the property, or through a combination of both. The variety of the methods of recapture require the various capitalization techniques.
Remaining Economic Life	The estimated period during which the improvements will continue to contribute to a property's value.
Replacement Cost	The cost required to replace an existing property with a property that has equivalent utility.
Reproduction Cost	The cost required to reproduce an exact replica of an existing property.
Residual Techniques	Capitalization techniques (within the income approach) in which an income amount is allocated to a property component of unknown value after subtracting the income return required by the property component of known value. This income amount is then capitalized into an estimate of

Term	Definition
	value of the unknown component.
Reversion	A lump-sum benefit in property that an investor receives or expects to receive at the termination of an investment.
Reversionary Rights	The rights of the lessor at the expiration of a lease; the estate returned or due to be returned.
Risk	Uncertainty about the outcome of future events; uncertainty about the future profitability of investments or projects; the possibility of not receiving the projected income.
Risk Rate	The annual rate of return on capital that is commensurate with the risk or uncertainty assumed by the investor; the rate of return or yield required to attract capital to the level of risk or uncertainty of that investment.
Safe Rate	The minimum rate of return on invested capital. Theoretically, the difference between the total rate of return and the safe rate is considered a premium to compensate the investor for risk, the burden of management, and the illiquidity of the capital invested; also known as the *risk-free* rate.
Sale Price	The amount of money a buyer agrees to pay and a seller agrees to accept in an exchange of property rights; sale price is based on a particular transaction, not necessarily on what the typical buyer would pay or the typical seller would accept.
Sale Price Adjustments	A procedure for deriving a value indicator by comparing the property being appraised to similar properties recently sold, by adjusting the sale prices of the comparables using elements of comparison.
Salvage Value	The value of property at the end of its economic life in its present use; the estimated market value for an entire property (e.g., a house) or for a part (or parts) of a property (e.g., the plumbing fixtures or doors of a house) that is removed from the premises for use elsewhere.
Scarcity	The present or anticipated under-supply of an item relative to the demand for it.
Taxable Value	For real property subject to article XIII A of the California Constitution, the base year full value adjusted for any given lien date as required by law or the full cash value for the same date, whichever is less, as set forth in section 51(a). For personal property, the full cash value (market value) on the lien date each year.
Unit of Comparison	The components into which a property may be divided in order to make comparisons, e.g., an apartment might be compared by price per apartment unit, price per room, price per gross square footage, or price per leasable square footage.

Term	Definition
Utility	The capacity of goods to evoke a desire for possession; wantedness; want-satisfying power.
Value	The power of one commodity to command other commodities in exchange; a ratio of exchange; present worth of future net benefits.
Weighted Average	An average that is calculated by weighting each component by a factor that represents its relative importance to the whole, multiplying each component by its assigned weight, and adding the products; used in the band of investment method.
Yield	The return on investment.
Yield Capitalization	A capitalization method used to convert future benefits to present value by discounting each future benefit at an appropriate yield rate or by developing an overall rate that reflects the investment's income pattern, value change, and yield rate.
Yield Rate	A measure of investment return (usually annualized) that is applied to a series of incomes to obtain the present value of each; examples are the interest rate, the discount rate, the internal rate of return, and the equity yield rate.

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