Draft

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**05/02/07**	Bill No:	**AB 1239**
Tax:	**Property Taxes**	Author:	**Garrick**
Related Bills:			

BILL SUMMARY

This bill would expand the new construction exclusion for the installation of fire safety devices installed in an existing building to additionally include those incorporated in the initial construction a new building, as specified.

ANALYSIS

CURRENT LAW

The California Constitution, Article XIII A, Section 2(c)(2) gives the Legislature the authority to exempt from the definition of new construction "[t]he construction or installation of any fire sprinkler system, other fire extinguishing system, fire detection system, or fire-related egress improvement, as defined by the Legislature."

The Legislature enacted Revenue and Taxation Code Section 74 to set forth the detailed definitions and requirements granting the new construction exclusion for fire-related improvements. The provisions of Section 74 currently limit its provisions to improvements made to an ***existing*** building or structure.

The types of improvements that would not be subject to property tax if constructed or installed in an existing building includes:

- fire sprinkler systems,
- fire extinguishing systems,
- fire detection systems, and
- fire-related egress improvements

PROPOSED LAW

New Buildings. This bill would amend Section 74 to add subdivision (f) to provide that the new construction exclusion also applies to fire sprinkler systems, other fire extinguishing systems, fire detection systems, and fire-related egress improvements, that are constructed or installed in a **new** building that is completed on and after the operative date of this bill.

Nonresidential Buildings – Limited Application. The proposed expansion of the new construction exclusion to new buildings would **not apply** in the case of an initial construction of a new **"nonresidential"** building if the improvements are required by law. For instance, if a multi-story office building is constructed, and a fire sprinkler system is required by law, the associated value of these improvements would not be exempt from property tax.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

Residential Buildings – Full Application. With respect to the construction of new residential types of properties (for example, single and multi-family residences, apartment buildings, hotels and motels) the exemption would be available whether or not the improvements are required by law.

Buildings Constructed for Sale – Exclusion Extended to Initial Purchaser. In the case of a property that is built for sale, the exclusion would continue to apply to the initial purchaser. Specifically, in determining the base year value to be established as a result of the change in ownership, the base year value would be reduced by the portion of the purchase price that is attributable to qualified improvements. The Board would be required to prescribe the claim form to continue the post-sale exclusion.

This bill is a tax levy and would be effective immediately.

IN GENERAL

Property Tax System. Article XIII, Section 1 of the California Constitution provides that all property is taxable, at the same percentage of "fair market value," unless specifically exempted, or authorized for exemption, within the Constitution. Article XIII A, Section 2 of the California Constitution defines "fair market value" as the assessor's opinion of value for the 1975-76 tax bill, or, thereafter, the appraised value of property when purchased, newly constructed, or a change in ownership has occurred. This value is generally referred to as the "base year value." Barring actual physical new construction or a change in ownership, annual adjustments to the base year value are limited to 2% or the rate of inflation, whichever is less. Article XIII A, Section 2 provides for certain exclusions from the meaning of "change in ownership" and "newly constructed" as approved by voters via constitutional amendments.

New Construction. The constitution does not define the term "new construction." Revenue and Taxation Code Section 70 defines it, in part, to mean:

> 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" or that converts the property to a different use. A major rehabilitation is any rehabilitation, renovation, or modernization that converts an improvement or fixture to the substantial equivalent of a new improvement or fixture.

With respect to any new construction, the law requires the assessor to determine the added value upon completion. The value is established as the base year value for those specific improvements qualifying as "new construction" and is added to the property's existing base year value. When new construction replaces certain types of existing improvements, the value attributable to those preexisting improvements is deducted from the property's existing base year value. (R&T Code §71)

New Construction Exclusions. Certain types of construction activity is excluded from assessment as "new construction" via constitutional amendment. Consequently, while these improvements may increase the value of the property, the additional value is not assessable.

Prop	Election	Subject	*Code*
8	November 1978	Disaster Reconstruction	§70(c)
7	November 1980	Active Solar Energy Systems	§73
23	June 1984	Seismic Safety (Unreinforced Masonry)	§70(d)
31	**November 1984**	**Fire Safety Systems**	**§74**
110	June 1990	Disabled Access Improvements (Homes)	§74.3
127	November 1990	Seismic Safety Retrofitting & Hazard Mitigation	§74.5
177	June 1994	Disabled Access Improvements (All Properties)	§74.6
1	November 1998	Environmental Contamination Reconstruction	§74.7

Legislative History of Fire Safety New Construction Exclusion

Proposition 31 was approved by voters at the November 6, 1984 general election. It was placed on the ballot by SCA 58 (Resolution Chapter 56, Statutes of 1984). A similar constitutional amendment had failed passage two years earlier at the November 1982 general election. Proposition 7 was placed on the ballot by ACA 53 (Res. Chap. 49, Statues of 1982).

The intent of the exclusion was to benefit the owner of the building in which the detection system is installed, by providing a shield against any increase in property taxes that might otherwise result from retrofitting the building with fire safety equipment. According to the analysis of the Assembly Committee on Revenue and Taxation, dated June 4, 1984, local ordinances were requiring that buildings be retrofitted because of a number of fire tragedies. Of particular concern was the cost of retrofitting hotels and motels. Consequently, the California Hotel and Motel Association sponsored the proposed changes to the Constitution to reduce the overall cost of making the fire safety improvements.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by Board of Equalization Member Michelle Steel. Its purpose is to encourage the installation of fire safety devices in the initial construction of properties as such improvements save lives and reduce property losses in the case of a fire.

2. **The current new construction exclusion is limited to improvements made to an existing building or structure.** This bill expands the new construction exclusion to qualified components of a new building.

3. **New construction exclusions remain in effect until the property changes ownership.** Generally, new construction exclusions remain in effect until the property changes ownership, at which point the entire property, including the portion of the property (or additional value) previously exempted from taxation via the new construction exclusion, is subject to reassessment to current market value pursuant to the change in ownership provisions of Proposition 13.

4. **In the case where property is built for immediate sale, this bill provides that the exclusion would continue to apply to the initial purchaser of the property.** Without these provisions, the bill would be ineffectual for any new building that is not intended to be occupied by the owner-builder. Once the property is sold (i.e.,

changes ownership) the entire property must be reassessed to its current market value for purposes of Proposition 13. This bill and AB 1485 (Leno) of this legislative session set a precedent of extending a new construction exclusion after a change in ownership for the first purchaser only. AB 1485 relates to an active solar energy system.

5. **This bill would require an assessor to subtract out the incremental value of qualified improvements when a new property that incorporates fire-related components is initially constructed.** This bill would set a precedent for exempting particular components of an entirely new building.

6. **Should the provisions related to fire egress improvements which is provided for improvements made to existing buildings be modified as the proposed exemption relates to new buildings?** With respect to the retrofitting of an existing building, there is an obvious bright line in determining what is a new or improved means of egress. Such a bright line would not be present in applying the exclusion to an entirely new building. For example, it might be argued that the cost of multiple stairwells, constructed as an ordinary component of a building, are eligible for exemption, as a fire egress improvement. To avoid the administrative uncertainties in applying a partial exemption to an entirely new building, it may be more practical to exempt those systems and costs that are distinctly identifiable, such as fire sprinkler systems, rather than those that are integral part of an entirely new building, such as stairwells, doors, and windows, that might be argued to be “egress” improvements.

7. **Currently claim forms are only expressly required in the case of property that is sold to the initial purchaser.** To aid in the efficient administration of this incremental exemption for a new building, claims should also be required to identity the value of the exempt improvements for owner-builders that intend to occupy the property.

COST ESTIMATE

This bill would not impact the Board’s administrative costs, the costs of prescribing the claim form are absorbable.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Current law excludes from classification of "newly constructed" the construction or installation on or after November 7, 1984, of any fire sprinkler system, other fire extinguishing system, fire detection system, or fire-related egress improvement, as defined, in an existing building. This bill would extend the exclusion to cover the construction or installation of these fire safety devices in certain new buildings.

For the purposes of this estimate, we will address the revenue impact separately for single-family residential units, multi-family residential units and non-residential units.

Single-family Residential Property. Staff estimates the cost of constructing or installing fire safety devices in new single-family residences is 1 percent of the total building cost on average. According to the California Construction Industry Research Board, the 2007 forecast cost for all single-family new construction is $19 billion. Most newly constructed residential properties do not feature fire sprinkler systems. Assuming ten percent of newly constructed homes were to include a fire sprinkler system, and further assuming the deduction for fire safety devices is recognized upon assessment by the county, the assessed value loss can be computed as follows:

[$19 billion x 10%] x 1% = $19 million

Multi-family Residential Property. Staff estimates the cost of constructing or installing fire safety devices in new multi-family residences is 2 percent of the total building cost on average. According to the California Construction Industry Research Board, the 2007 forecast cost for all multi-family new construction is $11 billion. The assessed value loss can be computed as follows:

$11 billion x 2% = $220 million

Non-residential Property. For non-residential property, the average cost range for fire safety devices is estimated at $1.50 to $4.00 per square foot. The estimated average cost of non-residential property per square foot in the state is $200. Therefore, the cost range of fire safety devices on average as a percentage of total square footage is [$1.50 to $4.00] / $200, or 0.8% to 2.0% of the total non-residential property cost. According to the California Construction Industry Research Board, the 2007 forecast cost for all non-residential new construction is $14 billion. The assessed value loss can be computed as follows:

$14 billion x [0.8% to 2.0%] = $112 million to $280 million

Under this bill however, where fire safety devices are required by law for non-residential property, no exclusion will apply. It is difficult to determine what percentage of non-residential property would qualify for this exclusion. Therefore, staff estimates that between ten and fifty percent, or between $11 million and $140 million of non-residential assessed value will be affected by this bill.

The revenue impact at the basic 1% property tax rate is then:

Single-family Residential Property	$19 million x 1% = $190,000
Multi-family Residential Property	$220 million x 1%= $2.2 million
Non-residential Property	[$11 million to $140 million] x 1% = $110,000 to $1.4 million

Revenue Summary

This bill would annually reduce property tax revenues at the basic 1% property tax rate by $2.5 million to $3.8 million.

Analysis prepared by:	Rose Marie Kinnee	(916) 445-6777	05/08/07
Revenue prepared by:	Chris Butler	(916) 445-4580	
Contact:	Margaret S. Shedd	(916) 322-2376	

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.