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TO COUNTY ASSESSORS:

PRINCIPLES OF NEW CONSTRUCTION VALUATION

Here is another in the series of letters concerning the implementation of Article XIII A of the Constitution. Presented are the philosophical basis for our original guidelines on new construction, some additional concrete examples of differences between maintenance and new construction, and clarification of the reappraisal techniques that should be applied so that both the original property and the newly constructed portion are properly valued.

In clarifying the term "newly constructed" as it is used in Board Rule 463, it must be pointed out that since the intent of the authors of Proposition 13 is not clear, the Board has attempted to define its content as concisely as possible. Implicit in the term "newly constructed" is the creation of something that did not previously exist. It implies construction or addition of previously nonexistent features. Renovation and restoration imply replacement of previously existing features with things that perform the same basic function; i.e., a replacement door is still a door; a sink, a sink; and a water pipe, a water pipe. Replacement or renewal of an already existing feature should be considered repair or maintenance and as such would not qualify as newly constructed.

Rule 463 qualifies new construction as alterations that "...result in a conversion to another use or an extension of the economic life of the improvement." Conversion to another use requires no additional explanation but the appraiser must be careful to differentiate between true extension of economic life and maximization of improvement life expectancy. Repairs and maintenance maximize life expectancy but do not create new uses or new economic life; neither do cosmetic changes nor limited renovations. Appraisers tend to equate such alterations with increased value but under a strict interpretation of Proposition 13, increased value is not grounds for reappraisal until the property is transferred. As a "rule of thumb" we suggest that work done on an improvement (presupposing no change in use) would not be considered new construction if it could reasonably be assumed that such work would be done periodically during the life of the improvement.

Examples of alterations that should not be considered new construction are:

- (1) Roof replacement

- (2) Replacement of galvanized waterlines with copper or plastic waterlines
- (3) Replacement of cast iron sewer lines with plastic
- (4) Replacement of knob and tube electrical wiring with romex-type cable
- (5) Replacement of gravity central heating with central forced-air heating
- (6) Replacement of wall or floor heating units with baseboard heaters
- (7) Replacement of old bathroom and kitchen fixtures with modern fixtures
- (8) Replacement of modern fixtures by period fixtures when restoring structures to their classical, original state
- (9) Replacement of wall or floor coverings
- (10) Replacement of wood-framed windows with metal frames
- (11) Replacement of dry rot or termite damaged joists, studs, rafters, stairway and/or exterior siding
- (12) Replacement or refinishing of molding strips, plaster, sheetrock, and wall paneling with similar substitute materials
- (13) Replacement of interior partitions

Examples of features that, if added, would be considered new construction are:

- (1) Converting existing floor space to an additional bath
- (2) Finishing previously unfinished areas such as attics, porches, and basement
- (3) Addition of any previously nonexistent structure
- (4) Addition of load-bearing walls

In order to maintain the integrity of Constitutional Amendment XIII A, the appraiser must value newly constructed property at its current market value. When appraising the newly constructed portion of the property, the use and correlation of all three approaches is both appropriate and recommended. The roll value for the total property upon completion of new construction is the factored base value minus deletions (demolition), plus the current market value of the newly constructed portion. In subsequent years, the roll value would be the current roll value trended at the appropriate inflation factor.

Board Rule 4 says that the market approach is the preferred approach if comparable sales are available. To value the newly constructed portion of a property by the market approach, the contributory value is measured by comparing recent market sales of similar properties with and without the newly constructed feature. Land values of both properties being equal, any difference in sale price should be attributable to the additional feature, and this residual should equal the value of the new construction. The roll value is established by adding the factored property value to the new construction value.

Similarly, the value of the newly constructed portion may be established by the income approach. In this instance, care should be used in selecting yield rates and typical income and expenses from the current market. Use of overall rates will distort the contributory value of the land, so it is recommended that a building residual approach be applied. Again, assuming the land values are equal, the difference in net economic rent between similar properties with and without the newly constructed feature is attributable to the additional feature. This income, when capitalized using current yield rates, establishes the current market value of the newly constructed feature.

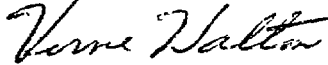
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In many instances, the scarcity of comparable sales data and the difficulty of making income projections will limit the appraiser to using the replacement cost approach. The very simplicity of the cost approach may make it desirable when time and resources are limited, but the appraiser should not fall into the trap of assuming cost equals current value. It is true that in the great majority of cases, current value reflects current cost and vice versa. However, in establishing the market value of the newly constructed portion of the property, the appraiser should use typical costs as indicated by similar current construction rather than the actual contract cost for the subject. Close attention should be given to size, quality, and the applicability of the addition. Adjustments may have to be made for under- or over-improvement.

The previously described valuation methods are also applicable to new construction classified as land and to fixtures.

Please refer any inquiries or additional questions to John McCoy of this division, (916) 445-4982.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

VW:cmm