SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair
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REAL PROPERTY TAX: VALUATION: ACTIVE SOLAR ENERGY SYSTEM

Enacts a specific valuation methodology for active solar energy systems.

Background

Property taxation. Section One of Article XIII of the California Constitution provides that all property is taxable unless explicitly exempted by the Constitution or federal law. The Constitution limits the maximum amount of any ad valorem tax on real property at 1% of full cash value, plus any locally-authorized bonded indebtedness. Assessors reappraise property whenever it is purchased, newly constructed, or when ownership changes. The Constitution and statute define those terms.

New construction exclusion. Section Two of Article XIIIA allows the Legislature to exclude from the definition of "new construction" the construction or addition of any active solar energy system (Proposition 7, 1980). Through various bills, the Legislature enacted the exclusion from 1980-81 to 1993-94, allowed it to sunset from 1994-95 to 1998-99, and reinstated it in 1998 (AB 1755, Keeley, 1998). After AB 1755 was set to sunset, the Legislature extended it until 2015-16 (AB 1451, Leno, 2008), again until 2024-25 (SB 871, Committee on Budget & Fiscal Review, 2014), and most recently until January 1, 2027 (SB 1340, Hertzberg, 2022).

As a result, installing a qualifying solar energy system does not increase or decrease the assessed value of the existing property, unlike other physical additions to real property, which are assessed at current market value and whose value is added to the existing base year value of the real property. Only active solar energy systems, fire sprinkler systems, seismic retrofits, disabled access improvements, and rainwater capture systems have similar treatment under the Constitution and statute.

State law defines an active solar energy system as one that uses solar devices, which are thermally isolated from living spaces or any other area where the energy is used, to provide for the collection, storage, or distribution of solar energy. An active solar energy system may be used for:

- Domestic, recreational, therapeutic, or service water heating.
- Space conditioning.
- Production of electricity.
- Process heat.
- Solar mechanical energy.

State law explicitly excludes from the definition:

- Solar swimming pool heaters.
- Hot tub heaters.
- Passive energy systems.
- Wind energy systems.

The new construction exclusion has neither historically nor currently distinguished between active solar energy systems affixed to residential real property from systems used by electrical generation companies that sell solar energy to energy purchasers.

Methods of assessment. As mentioned above, the California Constitution directs assessors to value property according to its fair market value. State law defines fair market value to mean "the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and seller have knowledge of all the uses and purposes to which the property adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes."

State law also establishes presumptions of value that make the process of determining fair market value simpler and more reliable, mainly by presuming that the market value of a property is its purchase price in an "open market transaction." However, an assessor can overcome this presumption upon a preponderance of the evidence. Additionally, a purchase price is only available for a property that is bought or sold. When a taxpayer constructs their own property, or when a sales price is unavailable, assessors must use other methods to determine value, namely cost, comparative sales, or income. The Board of Equalization's (BOE's) Assessor's Handbook advises assessors that each appraisal approach utilized should be carried out independently from the others, but while all three approaches to value should be considered, the use of all three may not always be appropriate. Instead, the nature of a property, its market, and the availability of data will normally indicate which approach is most applicable.

While state law contains specified methodologies for valuing specific kinds of personal property, such as certificated aircraft or certain possessory interests, it does not contain a preferred method of value for any form of real property. However, BOE guidance states that the replacement cost method is preferred when neither reliable income nor comparable sales are available, and when the income from the property is not so regulated as to make such cost irrelevant. BOE guidance adds that the income method is preferred 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.

Cost method. The cost approach generally attempts to calculate value "by applying current prices to the labor and material components of a substitute property capable of yielding the same services and amenities" and then applying a depreciation factor to arrive at a taxable base value. The cost approach is often preferred because many properties are rarely sold or do not have calculable incomes, but costs are usually easy to find.

Assessors can use reproduction cost, which is the cost to reproduce an existing property with a replica, or replacement cost, which is the cost to build a property of similar utility, as of a current date. Assessors usually calculate costs by reference to a price guide (BOE publishes several price guides and indices), then make any adjustments to account for the differences in value

between a specific property and the value in the guide or index. Under either reproduction or replacement, assessors then generally reduce the costs derived from the guide or index downward for several reasons, including physical deterioration, functional obsolescence, and economic obsolescence.

An assessor can use a trended historical cost approach or apply current prices when determining replacement cost. Under the first method, the assessor obtains the historical, or original, cost of the property, then factors this historical cost to the date of the appraisal using a price index. For example, a piece of manufacturing equipment purchased for $100,000 ten years ago has a trended cost of $120,000 if the price index shows 2% annual price increases for that kind of equipment. As a result, the taxable value of $120,000 is the amount the taxpayer would pay to replace the current property. However, because the equipment is now ten years old, the $120,000 value is too high because the taxpayer isn't replacing a new asset, they're replacing a ten-year old one. To reflect this lost value, the $120,000 is multiplied by a "percentage good factor," based on the useful or economic life of the equipment to reflect normal physical depreciation and normal obsolescence. There may be further depreciation that is not reflected in the above calculation, as well as other considerations necessary to arrive at fair market value. The law prohibits assessors using the cost method from including a component for entrepreneurial profit, unless market-derived evidence indicates such profit exists and has not been fully offset by physical deterioration or economic obsolescence.

Income method. The income method values an income producing property by estimating the present value of the property's expected future income stream. The income approach to value is used in conjunction with other approaches, typically when the property under appraisal is 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.

Intangibles. Property taxes are imposed on real property like land and buildings, as well as personal property, like office equipment and machinery. While state law says that intangible assets and rights are not themselves taxable, it also says that assessors and appraisers should *value* tangible property by assuming the presence of intangible assets or rights necessary to put the property to beneficial or productive use. For example, a license to operate a hazardous waste facility is not tangible property, but has considerable value because, without it, the facility's value is near zero. The law further directs that when valuing properties that are operated as a unit, and the unit includes intangible assets and rights, then the assessor should remove the fair market value of the intangible assets and rights contained within the unit.

As a result, assessors face the difficult task of assessing property at its fair market value while ensuring that the value of intangible assets does not incorrectly add to the value of taxable property; a task the can result in disputes and appeals. Two recent California Supreme Court decisions have wrestled with whether and how assessors should include or exclude the value of certain intangible assets and rights. The California Supreme Court held that the Board of Equalization cannot include the value of Emission Reduction Credits (ERCs) when calculating the replacement cost necessary for the taxpayer to construct an electric power plant and to operate it at certain air-pollutant emission levels.[1] The Court found that the ERCs value was for the business enterprise, not the property, so it must be excluded. The Court then held that the assessor correctly included a subsidy that the City of Los Angeles paid to a hotel owner to create an incentive for construction, as well as a one-time payment that a hotel manager paid to the

[1] Elk Hills Power, LLC v. Board of Equalization (2013) 57 Cal.4th 593

owner to secure the right to manage the hotel when valuing the JW Marriott and Ritz Carlton Hotel in downtown Los Angeles using the income method.[2] The Court distinguished these payments from the value of the ERC in *Elk Hills* because they enhance the revenue of the property regardless of its owner.

This treatment of intangibles generally applies to all forms of real property; there are no separate limitations on valuing intangibles for specific forms of property.

Appraisal units. Property is usually composed of many different things (buildings, other improvements, land), especially for property that produces income, like agricultural land or a manufacturing plant. Most of the time, assessors value all of these on a single property together, because they are typically bought and sold that way. For example, single family homes are sold as a combination of land and buildings, as buyers and sellers do not negotiate separate prices for the land and the buildings. Usually, assessors determine an appraisal unit according to the benefits that will be generated by the entire operating unit rather than the sum of the values of the individual parts. However, statute provides in specified cases for appraisal units to be separated; when considering declines in value caused by a calamity and measuring damage or destruction, the land, improvements, and fixtures are treated as separate appraisal units. BOE Property Tax Rule 474 also states that land is a separate appraisal unit for petroleum refining properties in the event of a disaster. As a practical matter, creating separate assessment units can provide for lower assessments because the growth in value of some parts of the property, such as land, does not offset the reduction in value in other parts, such as the solar energy system.

Statutory provisions enacting the new construction exclusion for active solar energy systems will sunset after January 1, 2027, unless extended by the Legislature. While the law will continue to exclude systems where construction has been completed, and some systems with construction in progress, assessors will begin valuing newly constructed systems after that date, following more than 45 years of being excluded. The Large-Scale Solar Association and the Solar Energy Industries Association want to create a new system for valuing nonresidential systems for property tax purposes, to increase certainty and uniformity.

Proposed Law

Senate Bill 1329 sets forth a methodology for the assessment of active solar energy systems, consisting of four major components:

- Preferred method of assessment.
- Specific definitions for "obsolescence" and "replacement cost new."
- Treatment of intangibles.
- Separate appraisal unit.

Method of assessment. SB 1329 states that assessors should value active solar energy systems under current law, including using the cost, comparative sales, and income methods. However, it states that the replacement cost new, less depreciation, is the preferred method.

Specific definitions. The measure provides that obsolescence must include the amount of any United States duties and tariffs. The assessor must also reduce replacement cost new by the

[2] Olympic & Georgia Partners, LLC v. County of Los Angeles (2025) – P.3d --, 2025 WL 2473858

amount of any government subsidies in the form of tax credits or other similar subsidies, as defined in the list of intangible rights and assets below. Assessors must then multiply that value by a depreciation percentage "good factor" and inflation cost index factor. SB 1329 limits replacement cost to the actual cost of the system to build, excluding developer step-ups and other costs. The measure also requires equipment cost index factors to be derived from specific publications, except that assessors must also reduce factors by amounts attributable to import customs and duties.

Intangibles. SB 1329 requires assessors to only include the *tangible* property comprising the active solar energy system in the taxable value, and not include *intangible* rights and assets relating to the going concern value of the business. The measure then specifies that those rights and assets include:

- Federal and state tax credits, cash grants, direct payments, or similar federal subsidies received or to be received;
- Contracts for energy, resource adequacy, ancillary services, or related market products;
- Renewable energy credits, as defined; and
- Environmental commodities, including, but not limited to, carbon credits and emission credits.

The measure states that it shall not be construed to mean that a business operating an active solar energy system does not also have intangible assets and rights commonly found in general businesses, including, but not limited to, concessions, franchises, workforce in place, customer lists, trademarks, and copyrights.

Appraisal units. SB 1329 states that an active solar energy system or portion thereof is a separate appraisal unit from any other property that is not excluded.

The bill's changes to the method of assessment, treatment of intangibles, and composition of the assessment unit would take effect immediately as the measure is a tax levy.

State Revenue Impact

Pending.

Comments

1. Purpose of the bill. According to the author, "Since 1980, solar energy systems on homes, businesses, and in big projects that feed into the electrical grid have been excluded from property taxes in California. That exclusion sunsets at the end of 2026 and solar will become fully taxable. Solar power remains crucial to helping California decarbonize our energy grid, so we must keep development in the state and cost to ratepayers low. SB 1329 would help ensure that solar power continues to grow in California by creating a standard for property taxes for all 58 counties for solar so that the industry is not priced out of California. To ensure that solar is provided to Californians at a fair and reasonable price, those who build solar need to know the way to calculate property tax regardless of where they build in the state. SB 1329 will allow California to continue to meet its clean energy and climate goals, keep project costs down, and bring new tax dollars to the state and local government."

2. Here and there. For many decades, active solar energy systems were among the few, and certainly the most valuable, forms of excluded new construction excluded. Should the current exclusion sunset on January 1, 2027, as provided in current law, assessors would value any newly constructed active solar energy system at fair market value, unlike those built in the past 45 years. SB 1329 creates a specific methodology for these systems, which would advance uniformity and certainty in assessments, and, in theory, help solar energy providers supply renewable energy at lower prices. However, counties where solar developers cite projects argue that its provisions will result in assessments below fair market value, resulting in less property tax revenue to fund public services – up to $60 million annually for the County of Kern. Significant solar generation facilities are also located in Fresno, San Bernardino, and Riverside counties. The County of Kern adds that the bill's specific methodology disproportionately and unfairly deprives those counties that approve large-scale solar systems of needed revenue, while the rest of the state benefits from less expensive solar power and counties that do not have large-scale solar systems bear no cost at all. The County also notes that they have lost significant revenue given the 45-year existence of the exclusion. The Committee may wish to consider whether SB 1329's potentially reduced property tax revenues for counties with more solar energy systems is worth its benefit to solar energy producers, and whether its allocation of the costs of meeting the state's climate and renewable energy goals strikes the right balance.

3. Precedents. As previously noted, current law does not contain any explicit direction for assessors to determine the value of certain forms of property in the way SB 1329 would for active solar energy systems. SB 1329 would also create several specific precedents:

- State law does not contain a preferred method of valuing real property. SB 1329 would state that the replacement cost new less depreciation is the preferred method for active solar energy systems. While a *preference* is not a *requirement*, and no presumption attaches to the preferred method, an assessor insisting on the income method would have to overcome the bill's preference in an appeal before an assessment appeals board or court.
- BOE guidance largely guides the determination of value using the cost method, which accounts for certain forms of obsolescence. Assessors correctly accounting for obsolescence when valuing property is backstopped by the property tax appeal process. SB 1329 says that valuation must include "all forms" of obsolescence, and that obsolescence includes external obsolescence, specifically including amounts of any United States duties and tariffs – the first known instance of California tax law explicitly accounting for the cost of duties and tariffs. Assessors note that while duties and tariffs may reduce value, reductions must generally be supported by market data.
- Replacement cost new is determined by measuring the change in prices of items necessary to construct the system between the year when the property is built and when it is assessed. Those costs are then multiplied by a percentage good factor because the system has been operating for some period of time, and thus is no longer new. SB 1329 would require the subtraction from replacement cost new any government subsidies, which does not explicitly exist for any other form of property, and could result in a lower value for a system simply due to the existence and amount of subsidies. BOE's guidance for wind properties states that while such subsidies may be considered economic obsolescence and indicate a lower value, any calculation of obsolescence depends on the attributes of a specific property.
- SB 1329 limits replacement cost to the actual cost of the system to build, excluding developer step-ups and other costs. Currently, assessors can add entrepreneurial profit,

when market-derived evidence indicates it exists and has not been fully offset by physical deterioration or economic obsolescence.

- Determining the presence of intangible assets or rights necessary to put the property to beneficial or productive use is a complex determination that varies from property to property. Assessors argue that SB 1329's limits on the consideration of intangibles strip out major economic drivers used by real buyers and sellers to price operating generation assets.
- Assessors also note that there is scant justification for treating the system as a separate assessment unit because they do not sell separately on the open market from the land and other buildings on the same property, and doing so is inconsistent with the statutory and case law, as well as standard appraisal practices.

4. Not like the others. As noted above, SB 1329 creates precedents that don't apply to other forms of real property. However, voters chose to treat active solar energy systems differently in 1980 and authorized the Legislature to implement the exclusion as it saw fit. Solar energy developers argue that, as a policy matter, providing clear and predictable property tax treatment justifies creating these precedents:

- The current exclusion has directly led to California's leadership position in cost-effective solar energy production necessary to meet state climate and reliability targets. Unless assessments after the expiration of the exclusion are transparent and certain, the financial model where developers sell electricity derived from solar under long-term contracts becomes strained. Proponents state that current assessments for non-excluded storage systems have varied considerably, with assessors incorrectly adding value from items like software, which has led to disputes and appeals.
- Solar developers don't often buy and sell systems, so valuing based on a value derived in a hypothetical open market doesn't suit this industry. Instead, developers build these systems themselves, and can easily demonstrate the costs they incur, so basing value on cost and not income is both fair and more accurate. Only systems constructed after January 1, 2027, are subject to assessment, so it should not be difficult to determine value using recently incurred costs.
- Large-scale solar systems in California already operate at a significant disadvantage compared to systems in nearby states. Proponents identify exclusions in Arizona and Texas, and a replacement cost methodology in Texas. Solar developers could simply cite projects in different states with more favorable tax treatment, and along with them employment and economic activity resulting from the system.
- Many counties require solar developers to pay development fees that endure for the life of the project to offset any reduced property tax revenue.

5. Related legislation. Last year, the Legislature enacted SB 710 (Blakespear), which provided that instead of the new construction exclusion for active solar energy systems being repealed as of January 1, 2027, it is no longer in effect after that date. Additionally, the Legislature also enacted AB 1516 (Committee on Revenue & Taxation), which provides that property owners acquiring a property for which the owner-builder built a system but did not claim an exclusion have three years from the date of purchase to file a claim for the exclusion that applies retroactively to the date construction is completed.

6. Related legislation, part two. This year, AB 2389 (Irwin) would extend the repeal date of the exclusion by five years and limit the active solar energy systems that qualify for the exclusion to

a "customer-sited" system that either has a "system size" of ten kilowatts or less, or is sited on the property of a "public entity customer." The Assembly Revenue & Taxation Committee approved the measure as amended on April 27th. Should AB 2389 be enacted, those systems would continue to be excluded from new construction after January 1, 2027, and SB 1329's provisions would apply to those systems that do not meet the above criteria.

7. Related legislation, part three. In 2022, the Senate approved SB 1340 (Hertzberg), which among other provisions, established a valuation methodology similar to SB 1329's for "nonqualified" active solar energy systems, defined as those with nameplate capacity above 20 megawatts of alternating current. The Assembly Appropriations Committee removed those provisions; as enacted, SB 1340 extended the new construction exclusion for two years.

8. Mandate. The California Constitution requires the state to reimburse local governments for the costs of new or expanded state mandated local programs. Because SB 1329 changes the way that assessors value real property, Legislative Counsel says that this bill imposes a new state mandate. The measure provides that the state shall not reimburse local agencies for property tax revenue losses, instead stating that, should the Commission on State Mandates determine that the bill imposes a reimbursable mandate, reimbursement must be made pursuant to existing statutory provisions.

Support and Opposition (5/1/26)

Support: Large-Scale Solar Association (Co-Sponsor)
Solar Energy Industry Association (Co-Sponsor)
American Clean Power - California
Arevon
California Energy Storage Alliance
California Solar & Storage Association
EDF Power Solutions
EDP Renewables North America, LLC
Environment California
Forefront Power, LLC
HES Renewables
Independent Energy Producers Association
Nexamp
Qcells North America
RWE Renewables America, LLC
Solar Gain West
Solar Technologies

Opposition: California Assessors' Association
County of Fresno
County of Kern

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