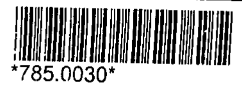

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April 6, 1998

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Mr. Charles R. Mack
Yolo County Counsel
625 Court Street, Room 201
Woodland, California 95695

Attention: Mr. Stephen B. Nocita
Deputy County Counsel

Re: Taxability of Possessory Interest in UC Student Housing Development

Dear Mr. Mack:

This is in reply to your letters of November 19, 1997 and March 13, 1998, signed by Mr. Nocita, in which you request the Board legal staff's view on whether a possessory interest in land owned by the University of California and in improvements to be constructed on that land is taxable where that possessory interest is held by a private developer for the purpose of constructing student housing. I have reviewed the agreements enclosed with those letters, the Ground Lease between the Regents of the University of California ("UC") and Catellus Residential Group, Inc. ("Catellus") and the Ground Sublease between Catellus and Beckett Hall, Inc. ("Beckett Hall") and based on those documents my understanding of the arrangement is as follows:

Under the terms of the Ground Lease, UC is leasing the land for a term of 40 years to Catellus for the purpose of constructing and owning and operating, or causing to be owned and operated, a student apartment complex ("project improvements"). As consideration, Catellus pays nominal ground rent of one dollar and tenders performance of all of its other obligations under the Lease.

Concurrent with the execution of the Lease, Catellus will enter into the Ground Sublease with Beckett Hall whereby Catellus subleases its interest in the land to Beckett Hall for a term of 40 years. Beckett Hall will pay Catellus annual rent of $110,000 to be increased by 2.5% per year. The project improvements will be owned, operated, maintained and repaired by Beckett Hall until the expiration or earlier termination of the Sublease. In addition, Beckett Hall intends to enter into an agreement to lease the project improvements to UC for a specified period of time. This agreement, referenced in the Sublease as the "Projects Improvement Lease", was not available for review.

For the reasons set forth below, we are of the opinion that. once completed and to the extent that they are leased to students and other persons affiliated with the university, the project improvements will be exempt as property used exclusively for state university purposes within the meaning of Article XIII, section 3, subdivision (d) of the California Constitution. Similarly, the land, though owned by UC, will be exempt as property used exclusively for state university purposes (Article XIII, section 3, subdivision (d), and *Mann v. County of Alameda* (1978) 85 Cal.App.3d 505), to the extent that students and other persons affiliated with the university are residing in the project improvements.

Law and Analysis

Article XIII, section 3, subdivision (d) exempts from property taxation "[p]roperty used for libraries and museums that are free and open to the public and property used exclusively for public schools, community colleges, state colleges and state universities."
Section 3, subdivision (d) contemplates an exemption for property owned by a private taxable person or entity, leased by one of the enumerated entities and used exclusively for purposes of the lessee entity. State university, within the meaning of section 3, subdivision (d) includes the University of California. *Regents of the University of California v. State Board of Equalization* (1977) 73 Cal.App.3d 660. Property "used exclusively" for state university purposes includes property leased by the University of California which is intended for use as student housing and is occupied by University of California students and other persons affiliated with the university. *Mann v. County of Alameda, supra.*

Based on the Lease and Sublease provisions pertaining to operation of the project improvements it appears that, upon completion, the project improvements will qualify for the exemption. Paragraph 3.2.1.1 of each agreement, the terms of which are substantially identical, provides that space in the project improvements shall be leased only to "permitted tenants". "Permitted tenants" means continuing undergraduate, graduate and professional program students of the University of California, Davis Campus and other persons affiliated with the Davis Campus as permitted by the Davis Campus Director of Housing. Paragraph 3.2.1.2 provides that the premises shall be held and operated in accordance with University of California, Davis campus rules, regulations and policies. Paragraph 3.2.1.3 provides that the Davis Campus Student Housing Office will monitor operation of the project improvements for compliance with the terms of the Lease. The foregoing provisions clearly require that the project improvements be used exclusively for the housing of students and other persons affiliated with the university and, insofar as those provisions are respected, the property will be exempt.

However, the exemption is not available to the extent that the property is not exclusively used for the housing of students and University-affiliated persons. Where a portion ~~of the~~ property is exempt because it is exclusively used for state university purposes and such property is clearly identifiable from a portion used for nonexempt purposes, then apportionment and

taxation of the nonexempt portion is proper. *Oates v. County of Sacramento* (1978) 78 Cal.App.3d 745. Paragraph 3.2.2.2 provides that if Beckett Hall is unable to fill the apartment units with "permitted tenants", then, at the discretion of UC, the units may be rented to other persons. In the event that apartment units are leased to persons who are not "permitted tenants", then those units and that portion of the common property subserving those units will not be exempt.

Furthermore, property in the process of construction, such as the project improvements, necessarily may not be exclusively used for a qualifying exempt purpose, which purpose contemplates a functioning apartment complex. Therefore, property under construction is taxable unless exempt under another provision of law. With regard to property under construction, Section 5 of Article XIII provides that

> Exemptions granted or authorized by Sections 3(e), 3(f), and 4(b) apply to buildings under construction, land required for their convenient use, and equipment in them if the intended use would qualify the property for exemption.

Because the project improvements are exempt under subdivision (d) of Section 3 and there is no specific reference in section 5 to that subdivision, there is no exemption available until they are completed and put to their intended use as student housing.

As to the land, though owned by UC, it too will qualify for exemption under Article XIII, section 3, subdivision (d) and *Mann v. County of Alameda, supra*, to the extent that students and other persons affiliated with the university reside in the project improvements.

In *Mann v. County of Alameda, supra*, the court held that students' possessory interests in family rental housing owned by the university was exempt under Section 3, subdivision (d). The university was a state university within the meaning of the subdivision, and the students' leasehold interests were property used exclusively for the university within the meaning of the exemption. The court at page 509 rejected an argument that Section 3, subdivision (d) was intended to apply only to property that was not state-owned, reasoning that "insofar as section 3, subdivision (d), might relate to state-owned property, it would be surplusage and, hence, it should not be so construed." The court also reasoned that an anomaly would be created if section 3(d) were not applicable to the possessory interests at issue since a student's interest would be taxable if the land were owned by the state, but if the state leased the land from a private owner and subleased to the student it would not be.

Although in *Mann v. County of Alameda, supra*, the university owned the land, and here, the university owns the land and leases it to Catellus, which subleases the land to Beckett Hall, determinative in our view is that it is to ~~be~~ students and other persons affiliated with the university using the land, the same as the project improvements; and as such, the property, land and improvements, will be used exclusively for the university within the meaning of the

exemption. Note that the Sublease provides in paragraph 5.1, in pertinent part, that the land is to be used only as "a student apartment complex. containing 181 units plus commons building and parking." Until the project improvements are completed and put to their intended use as student housing, however, the taxable possessory interest in the land would be assessable because of the in applicability of Section 5 of Article XIII.

Finally, in our view, *Connolly v. County of Orange* (1992) 1 Cal.4th 1105, is not applicable in this instance. As indicated by the court in that case, the faculty residences on the university land were owned by the faculty members, and the issue was whether under section 3, subdivision (d) residential use of a privately owned home was a use that could be considered "exclusively for" the entity or organization for whose benefit the exemption was granted. As you are aware, for the reasons set forth therein, the court concluded that it could not be.

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

Louis Ambrose
Tax Counsel

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cc: Mr. Richard Johnson (MIC:63)
Mr. Rudy Bischof (MIC:64)
Mr. Pete Gaffney (MIC:64)
Ms. Jennifer L. Willis (MIC:70)