



## STATE BOARD OF EQUALIZATION

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No. 79/34

February 16, 1979

TO COUNTY ASSESSORS:

AMENDMENT TO ASSESSORS' LETTER NO. 78/137,  
VALUATION OF PRIVATE, FEE OWNED PROPERTY  
SUBJECT TO LEASE AGREEMENTS

During a Board of Equalization hearing held on September 26, 1978 some changes to Board Rule 462 dealing with the valuation of private, fee owned property subject to lease agreements were approved. These changes require the modification of our previous assessors' letter (78/137) on this subject.

Assessors' letter 78/137 made the following statement: "When title to the fee simple estate passes from one party to another, the entire property will be revalued as of the date of change and factored forward with appropriate CPI adjustments." The statement is amended to read: "When title to the fee simple estate passes from one party to another and ten years or less remain on the lease, the entire property will be revalued. When more than ten years remain on the lease, only the fee rights retained by the lessor (reversion) will be revalued as of the date of the change and factored forward with appropriate CPI adjustments."

An additional change involves that portion of the fee rights (reversion or leasehold) that is not subject to revaluation when a sale occurs or a lease is created. This particular interest will be subject to a value limitation determined by a comparison of the current value of that interest with the factored base year value of that interest. The lower of the two is the value to be enrolled along with the interest subject to reappraisal. The logic of this approach is that the total taxable value can never exceed the current total market value and the reduction of value from a higher updated base year value to a lower current value is authorized by Proposition 8.

When determining the base year split between leasehold and reversion, all data (term, yield rate, and rent) shall be based upon reasonable considerations applicable to the lease of such property at that particular point in time. The enclosed questions and answers reflect the above changes.

Please refer any questions concerning legal interpretations to Mr. Robert Milam of our Legal Staff, (916) 445-3076; direct questions dealing with assessment or appraisal procedures to Mr. John McCoy, (916) 445-4982.

Sincerely,

*Verne Walton*

Verne Walton, Chief  
 Assessment Standards Division

VW:sk  
 Enclosures

QUESTIONS AND ANSWERS PERTAINING  
TO THE VALUATION OF PRIVATE, FEE OWNED PROPERTY  
SUBJECT TO LEASE AGREEMENTS

1. QUESTION: How would you handle the valuation for March 1, 1979 of a private, fee owned property which is sold February 1979 and which is under a lease which began in January 1976 and expires January 1990?

Assumptions:

(1) Market values of:

	<u>Total Property</u>	<u>Leasehold</u>	<u>Reversion</u>
March 1, 1976	\$ 81,450	\$60,000	\$21,450
February 1979	118,000	76,640	41,360

(2) Present capitalization rate = 10% (inclusive of taxes).

ANSWER: In accordance with the Board's interpretation of Revenue and Taxation Code Section 110.6, the sale of the fee simple estate coupled with a lease with greater than ten years remaining, constitutes a change of ownership of the lessor's interest (reversion) only and necessitates a revaluation of that interest as of the date of the change, factored forward with appropriate CPI adjustments. The value for the non-revalued portion (leasehold) shall be the lesser of the factored base year value of that portion or the current value of that portion (current total market value less the current value of revalued portion).

SOLUTION: The leasehold value remains at \$60,000 factored forward to a March 1, 1979 value.

$$\$60,000 \times 1.0612 = \$63,672$$

The present value of the reversion as of February 1979 may be determined as follows:

$$\$118,000 \times .350494 \text{ (PW1, 11 yrs. @ 10\%)} = \$41,358$$

Total property value for 1979 roll:

Leasehold	\$63,672 <sup>1/</sup>
Present value of reversion	<u>41,360</u>
	\$105,032

<sup>1/</sup> If the current value of the leasehold had been less than the factored base year leasehold value, the current leasehold value would be used.

2. QUESTION: How would you handle the valuation for March 1, 1979 of a private, fee owned property in which a lease is created in January 1979 for an 11 year period?

ANSWER: The leasehold will be valued as of the date of creation and the value factored forward with appropriate CPI adjustments. The reversionary value will be the lesser of either the factored 1975 base year value or the current value of that portion (current total market value minus current leasehold value).

EXAMPLE: Assume the market value of the property as of March 1, 1975 was \$60,000 and the value of the leasehold interest base on a capitalization of the 1975 economic rental income was \$40,000. By subtracting the value of the leasehold interest from the market value of the total property, the result is the amount attributable to the reversionary rights in 1975 or \$20,000. The March 1, 1979 taxable value of the total property would be determined as follows (assuming 1979 economic rent); assume further that due to an economic decline, the market value as of January 1979 is \$50,000.

1979 leasehold value: \$5,000 (net annual market income)  
 x 6.4951 (pw 1/p at 10% for 11 years)  
 \$32,475

1975 factored reversionary value:  
 \$20,000  
 x 1.0824  
 \$21,648

1979 current reversionary value:

(1979 total market value)	\$50,000
(1979 leasehold value)	<u>- 32,475</u>
	\$17,525

Total taxable value as of March 1, 1979:

Leasehold	\$32,475
Reversion <u>2/</u>	<u>17,525</u>
Total	\$50,000

2/ The current value of the reversion is less than the factored base year value of the reversion. If the factored value of the reversion (\$21,648) had been added to the 1979 leasehold value, the resultant amount (\$54,123) would exceed the current total market value of \$50,000.