Issue Paper Number **02-025**

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

☐ Board Meeting
☐ Business Taxes Committee
☐ Customer Services and Administrative Efficiency Committee
☐ Legislative Committee
☒ Property Tax Committee
☐ Other

ASSESSORS' HANDBOOK SECTION 510, *ASSESSMENT OF TAXABLE POSSESSORY INTERESTS*

I. Issue

Should the Board of Equalization (Board) authorize publication of the revised Assessors' Handbook Section 510, *Assessment of Taxable Possessory Interests* (AH 510)?

II. Staff Recommendation

Staff recommends that the attached AH 510 be authorized for publication.

III. Other Alternative(s) Considered

None

IV. Background

Under Government Code sections 15606 et seq., the Board is charged with the duty of administratively enforcing and interpreting the statutes governing the local assessment function. In this regard, a specific requirement of the Board is that it prepare and issue instructions designed to promote property tax assessment uniformity throughout the state. The Assessors' Handbook, a compendium of manuals on assessment practices, is published by the Board as one means of fulfilling this requirement.

In February, 1955, the original version of the manual on the assessment of possessory interests was issued as Assessors' Handbook Section 517, *Appraisal of Possessory Interests*. The manual was subsequently revised in 1968, 1971, and 1974. In 1997, the manual was reformatted and retitled *Assessment of Possessory Interests*, without change in content. At the same time, the manual was renumbered as Assessors' Handbook Section 510.

In this revision, the manual has been substantially reorganized and rewritten. It has also been retitled as *Assessment of Taxable Possessory Interests*. Notably, this revision features the following: 1) greater discussion of the standards, or criteria, for establishing that a taxable possessory interest exists; 2) coverage of the application of Article XIII A of the California Constitution to taxable possessory interests and 3) inclusion of a "special topics" chapter that discusses statutory provisions that apply to specific types of taxable possessory interests and other special issues.

Staff worked with interested parties, including representatives from the California Assessors' Association and the California Taxpayers' Association, during the revision of this handbook section. The attached draft represents concurrence among interested parties who participated in the revision project.

V. Staff Recommendation

A. Description of the Staff Recommendation

Authorize publication of the attached revised Assessors' Handbook Section 510, *Assessment of Taxable Possessory Interests*.

B. Pros of the Staff Recommendation

Publication of the revised AH 510 will promote uniformity throughout the state with respect to the assessment of taxable possessory interests. The proposed revision addresses the most recent statutory amendments, regulatory changes, judicial decisions, and Board policies on the various topics within this handbook section.

C. Cons of the Staff Recommendation

None

D. Statutory or Regulatory Change

None

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

The estimated cost impact for printing and distributing copies of the revised handbook section is $2,170.

2. Revenue Impact

None

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

The revised handbook section is scheduled for distribution by the end of December 2002. In order to meet this deadline, the Board must approve the revised draft of Assessors' Handbook Section 510, *Assessment of Taxable Possessory Interests*, at its December 18, 2002 meeting.

VI. Alternative 1

A. Description of the Alternative

Not applicable.

Prepared by: Property and Special Taxes Department, Assessment Policy and Standards Division; Legal Department, Property Taxes Section

Current as of: November 15, 2002

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ASSESSORS' HANDBOOK
SECTION 510

ASSESSMENT OF TAXABLE POSSESSORY INTERESTS

DECEMBER 2002

CALIFORNIA STATE BOARD OF EQUALIZATION

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FOREWORD

The original version of this manual was issued as Assessors' Handbook Section 517, *Appraisal of Possessory Interests*, in February 1955, shortly before the landmark decision in *De Luz Homes, Inc. v. County of San Diego*. The manual was revised in 1968, 1971, and 1974. The 1971 revision was significant, incorporating the provisions of the first set of property tax rules to address taxable possessory interests, which were also adopted by the Board that year. The 1974 revision added a chapter about the appraisal of ski resorts, including a sample appraisal of this form of taxable possessory interest. In 1997 the manual was reformatted, renumbered, and retitled *Assessment of Possessory Interests*, without change in content.

In this revision, the manual has been substantially reorganized and rewritten (and retitled as *Assessment of Taxable Possessory Interests*). Notable differences between this and the previous manual include the following: 1) greater discussion of the standards, or criteria, for establishing that a taxable possessory interest exists; 2) coverage of the application of Article XIII A of the California Constitution (added by 1978's "Proposition 13") to taxable possessory interests (law that came into being after the previous version of the manual); and 3) inclusion of a "special topics" chapter that discusses statutory provisions that apply to specific types of taxable possessory interests and other special issues. The chapter and sample appraisal concerning ski resorts has been deleted.

Based on data supplied by assessors and Board data, the total assessed value of taxable possessory interests in California was about $25 billion for the 2000 assessment year, which represented about 1.1 percent of the assessed value of all property subject to taxation ($2.3 trillion). While this may seem insignificant, the relative importance of taxable possessory interest assessments to the local assessment roll varies from county to county; in a few smaller counties in particular, taxable possessory interest assessments represent a significantly higher percentage of the local assessment roll than the statewide average and hence also a greater part of the assessment workload.

The valuation of taxable possessory interests is a specialized type of valuation that, in large part, is applicable only to valuation for property tax purposes, and this manual is primarily directed toward property tax appraisers and others working in assessors' offices. But we also hope the manual will be useful to others with questions concerning this form of assessment.

Section 15606, subdivision (c), of the Government Code directs the State Board of Equalization to prescribe rules and regulations governing local boards of equalization in the performance of their duties, and subdivision (f) provides that the Board shall issue instructions, such as those set forth in this handbook. While regulations adopted by the State Board of Equalization are binding as law, Board-adopted handbooks are advisory only. Nevertheless, courts have held that they may be properly considered as evidence in the adjudicatory process.[1]

As part of the process of producing this manual, Board staff worked with members of the California Assessors' Association, industry representatives, and other interested parties to solicit input for this handbook section. The Board approved this section to the handbook on __________.

David J. Gau
Deputy Director
Property and Special Taxes Department
December 2002

[1] *Coca-Cola Co. v. State Board of Equalization* (1945) 25 Cal.2d 918; *Prudential Ins. Co. v. City and County of San Francisco* (1987) 191 Cal.App.3d 1142; *Hunt-Wesson Foods, Inc. v. County of Alameda* (1974) 41 Cal.App.3d 163.

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CHAPTER 1: INTRODUCTION

Rights in real property are often compared to a bundle of sticks, with each stick representing a different right or interest. The entire bundle of sticks represents the complete set of rights, which is called the fee simple interest.

The bundle of rights can be divided in almost innumerable ways. In a possessory interest, the ownership of the possessory rights in real property is separated from the ownership of the fee interest. Generally, a possessory interest consists of a right to the possession of real property for a period less than perpetuity by one party, the holder of the possessory interest, while another party, the fee simple owner, retains the right to regain possession of the real property at a future date.

The most common example of a possessory interest is the interest created by a lease. The tenant's (or lessee's) right to possession of the property is called the leasehold interest. The landlord's (or lessor's) right to receive rents during the term of the lease and to regain possession of the property when the lease terminates is called the leased fee interest. In the case of privately owned real property, both the tenant's and the landlord's interests are taxable, and typically both interests are valued and assessed in the aggregate to the landlord, or fee owner. It is not necessary, or administratively feasible, for the assessor to separately assess the value of the leasehold (i.e., possessory) interest and the value of the leased fee (i.e., nonpossessory) interest; instead, the assessor typically makes a single assessment of the entire taxable interest in the real property.

The subject of this manual (as the separately published sections of the *Assessors' Handbook* are often referred to) is the assessment of taxable possessory interests. A "taxable possessory interest" is a possessory interest that is separately taxable to the possessor. For introductory purposes, a taxable possessory interest can be defined as the taxable interest held by a private possessor in publicly owned real property. The public owner may be the United States of America and its administrative instrumentalities; the state of California; or one of California's local jurisdictions, which include counties, cities, and special districts. With a taxable possessory interest, since the underlying fee simple interest held by the public owner is almost always tax exempt, it is necessary to separately value the possessory interest held by the private possessor.[2]

The legal basis for the taxation of taxable possessory interests is found in the general mandate of the California Constitution, article XIII, section 1, that all property is taxable unless otherwise provided by the California Constitution or federal law. "Property," as defined in sections 103 and 104 of the Revenue and Taxation Code, includes "all matters and things, real, personal and mixed, capable of private ownership," and "real estate," or "real property," includes "the possession of, claim to, ownership of, or right to possession of land and improvements." There is also statutory,

[2] The vast majority of taxable possessory interests involve tax exempt publicly owned real property. It is possible, however, to have a taxable possessory interest in taxable publicly owned real property. This occurs when the publicly owned real property is taxable under section 11 of article XIII of the California Constitution. The assessment of taxable possessory interests in taxable publicly owned property is discussed in Chapter 5. Also, with one minor exception discussed later, taxable possessory interests may only exist in real property, and taxable possessory interests are classified as real property for assessment purposes. This is discussed in Chapter 2.

regulatory, and judicial authority for the assessment, under specified conditions, of the private, beneficial right to the possession of publicly owned real property.[3]

Thus, although publicly owned real property is generally either immune from taxation—in the case of federal property—or exempt from taxation—in the case of state and local government property—under certain conditions, the private, beneficial right to the possession of publicly owned real property is subject to separate assessment as a taxable possessory interest.

In brief, the remaining contents of this manual are as follows:

- In Chapter 2, we discuss one of the two fundamental questions of taxable possessory interest assessment: how to determine whether the relation between the private possessor and the publicly owned real property constitutes a taxable possessory interest. The answer to this question is determined by legal criteria. It is also a threshold question, because if there is no taxable possessory interest, there is obviously nothing to assess.
- In Chapter 3, we discuss the second fundamental question: how to value a taxable possessory interest. The valuation approaches used with taxable possessory interests are similar to those used to value other real property, but they must be modified because only a partial interest is being valued, not the full fee simple interest generally valued in property tax assessments.
- A taxable possessory interest assessment is subject to the provisions of article XIII A of the California Constitution (added by 1978's "Proposition 13") and its implementing legislation and regulations. We discuss the application of article XIII A to taxable possessory interest assessments in Chapter 4.
- Finally, in Chapter 5, we address several "special topics" associated with the assessment of taxable possessory interests. Among other topics, this chapter discusses assessment discovery, reviews several specific statutory provisions that apply to certain types of taxable possessory interests, and analyzes the assessment of taxable possessory interests in taxable publicly owned real property (i.e., real property that is taxable under section 11 of article XIII of the California Constitution).

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[3] Unless otherwise indicated, all references to "section" refer to sections of the California Revenue and Taxation Code and all references to "rule" or "property tax rule" refer to a section of Title 18, California Code of Regulations.

Chapter 2: Defining a Taxable Possessory Interest

This chapter attempts to provide the appraiser with a general understanding of what constitutes a taxable possessory interest, that is, how a taxable possessory interest is defined in California law. First, we present a brief review of the legal development of the topic. Second, we analyze the current statutory and regulatory provisions that define taxable possessory interests: namely, Revenue and Taxation Code section 107 and Property Tax Rule 20. Third, we discuss a few special cases concerning what constitutes a taxable possessory interest. Finally, we present examples of property relations that do and do not constitute taxable possessory interests.

Legal Background

There have been many appellate cases concerning what constitutes a taxable possessory interest. A comprehensive review of these cases is beyond the scope of this manual. The purpose here is much more limited: to provide some brief legal background to facilitate the discussion of current statutory and regulatory provisions in the next section.[4]

There is longstanding judicial support for the taxable nature of the private possession of publicly owned property. In 1859, in *State v. Moore*, the California Supreme Court held that a private mining claim on federal land constituted taxable property, even though the land itself (i.e., the underlying fee simple interest) was immune from taxation under the terms of the agreement that admitted California to the Union. In *Moore*, the court began the process of defining a taxable possessory interest:

> The term 'property in lands' is not confined to title in fee, but is sufficiently comprehensive to include any usufructuary interest, whether it be a leasehold or a mere right of possession. Several persons may have, in the same land, a property which is subject to taxation, and it is not perceived that the fact, that the property of the Government is exempt from taxation, affects the right to tax the interest which private individuals have acquired in the same property. Exemption from taxation is a privilege of the Government, not an incident of the property.[5]

Shortly thereafter, in *People v. Shearer*, the California Supreme Court again recognized a private taxable interest in federal land. A private possessor, Shearer, had adversely possessed federal lands for agricultural purposes, also constructing improvements. The court ruled that the private possessor's mere occupancy, or possession, constituted a taxable interest, as did the improvements to the land constructed by the possessor:

> The possession itself of the public lands whether by naked trespassers, or those who claim in addition a right of pre-emption, as to everybody except the United States, have always in California, and in most, if not all the new States, been

[4] The Appendix contains a list of cases relevant to taxable possessory interests.
[5] *State v. Moore* (1859) 12 Cal. 56.

> regarded as valuable property interests…. Such possession of the public lands, and the improvements put upon them, are, therefore, recognized and protected as a valuable species of property in the possessor.
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>
> It is not the land itself, nor the title to the land, nor is it the identical estate held by the United States. It is not the pre-emption right, but it is the possession and valuable use of the land subsisting in the citizen. Why should it not contribute its proper share, according to the value of the interest, what it may be, of the taxes necessary to sustain the Government which recognizes and protects it.[6]

There were also early statutory enactments involving taxable possessory interests. In the Field Codes of 1872 (an early codification of California law), the possession or right to possession, as distinguished from the ownership, of land and improvements became taxable. In 1895, the taxable nature of a possessory right in tax-exempt land first received statutory recognition. In 1921, a statute first specifically provided for the assessment of taxable improvements on tax-exempt land.

In 1919, in *San Pedro, Los Angeles & Salt Lake Railroad Co. v. City of Los Angeles*, the California Supreme Court applied the same rationale for taxing possessory interests in federal lands to state lands.[7] The case involved a leasehold interest in state tidelands. The court characterized the leasehold as a property interest fully taxable pursuant to the constitutional mandate that all nonexempt property was subject to tax, concluding that the reversion holder's (i.e., the public owner's) tax-exempt status should not allow the leasehold interest to escape taxation and that the lessee should be separately assessed and taxed on the value of the leasehold interest.

In 1939, existing California tax law was recodified into the Revenue and Taxation Code, which became effective February 1, 1941. At that time the Legislature also enacted the first possessory interest law. This new statute reinstated the provisions of section 3820 of the old Political Code that had defined a possessory interest as (1) "possession of, claim to, or right to the possession of land or improvements, except when resulting from ownership of the land or improvements" and (2) "taxable improvements on tax exempt land" into the initial version of Revenue and Taxation Code section 107. Then, as now, section 107 defines a taxable possessory interest as an interest in tax-exempt land and improvements only; the statutory definition of a possessory interest excludes interests in personal property.

Kaiser v. Reid is the most significant "modern era" case that addresses what constitutes a taxable possessory interest.[8] The 1947 case involved Kaiser Co.'s exclusive possession of federally owned shipyards during World War II. In its holding, the California Supreme Court provided a set of criteria, or standards, for determining when a private possessory right constitutes a taxable possessory interest. These criteria still provide the legal framework for defining taxable

[6] *People v. Shearer* (1866) 30 Cal. 645, 655-657.
[7] *San Pedro, Los Angeles & Salt Lake Railroad. Co. v. City of Los Angeles* (1919) 180 Cal. 18.
[8] *Kaiser Co., Inc. v. Reid* (1947) 30 Cal.2d 610.

possessory interests. In *Kaiser*, the court established three criteria to determine when a possessory interest exists:

1. The possessor must possess a right to possess public land for an ascertainable period.
2. The possessor must hold the interest exclusive "against all the world, including the rightful owner."
3. The possessor must receive a private benefit.

The law subsequently has evolved such that four primary criteria—each of which derives, directly or indirectly, from *Kaiser*—must be met for a possessor's interest in publicly owned real property to constitute a taxable possessory interest:

1. Independence
2. Durability (*Kaiser*'s "ascertainable")
3. Exclusivity
4. Private benefit

These criteria have been codified into both statute and regulation and will be discussed at greater length in the next section.

Another important aspect of *Kaiser*, related to its criterion of durability, was its holding that neither the government's ability to terminate a contract at will nor its prohibition on a transfer of the contractor's interest reduced the interest to a "nontaxable license." The court reasoned that, until the date of termination, the contractor had "exclusive possession of the premises against all the world, including the owner." The court found that the government's restrictions were matters that affected valuation, not whether or not a taxable possessory interest existed.

CURRENT STATUTORY AND REGULATORY PROVISIONS

In 1971, the Board incorporated the *Kaiser*-based criteria into its first group of administrative regulations governing the assessment of taxable possessory interests. In 1996, the criteria were incorporated into statute through amendments to existing section 107. Parts of then-existing Property Tax Rule 21 (the regulation that had addressed what constitutes a taxable possessory interest) were inconsistent with amended section 107, and a new regulation was promulgated in 1997, Property Tax Rule 20, which defines a taxable possessory interest in a manner consistent with the amended section 107.[9]

[9] Portions of Property Tax Rule 21 remained in effect but were subsequently encompassed in new Property Tax Rule 21, adopted in 2002, which addresses the valuation of taxable possessory interests.

Thus, section 107 and Property Tax Rule 20 are the primary statutory and regulatory sources that address what constitutes a taxable possessory interest. The rule follows the statute closely but clarifies it by defining several important terms that appear, but are not defined, in the statute. The following discussion focuses on the provisions of the rule.[10]

Rule 20 begins by defining a "possessory interest" as an interest in real property that results from the possession, a right to the possession, or a claim to a right to the possession of land and improvements that is independent, durable, exclusive of the rights held by others in the property and that provides a private benefit to the possessor.

The first part of the definition ("the possession, a right to possession, or a claim to a right to the possession") derives from the early case law discussed above that broadly construes the type of property relation that could give rise to a taxable possessory interest (this is also the language that appeared in the first version of section 107 in 1941).[11] The second part of the definition ("independence, durability, exclusivity, and private benefit") derives from *Kaiser* and subsequent case law drawing on it.

The rule then states that a possessory interest includes "taxable improvements on tax-exempt land." This refers to privately owned improvements constructed or owned by the possessor (i.e., not the public owner) on the land subject to the taxable possessory interest. According to this provision a possessory interest includes all improvements constructed pursuant to a possessory interest in land that become the property of the public owner at the termination of the possession, whether the improvements are constructed at the possessor's or the public owner's expense. However, improvements owned by the possessor that do not become the property of the public owner at the end of the term of possession fail the ownership test of Rule 20(a)(1) and, thus, are not taxable possessory interests.[12] As mentioned earlier, this provision dates to a 1921 statute, which in turn dates back to early case law, such as *People v. Shearer*.

Finally, the rule defines a *taxable* possessory interest as simply "a possessory interest in publicly owned real property." Thus, the overall structure of the definition is to first define possessory interests in a manner specific to property taxation and then to define a taxable possessory interest as simply a possessory interest in publicly owned real property. [13]

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[10] The Appendix contains the statutes and regulations pertinent to taxable possessory interests.

[11] Whether or not a taxable possessory interest exists does not depend on the type of document, if any, that evidences the possession, right to possession, or claim to a right of possession. The fact that no written document exists does not mean that a taxable possessory interest does not exist. Further, if a document does exist, it need not be denominated as a lease (i.e., it could be called an agreement, a permit, a contract, etc.).

[12] Upon renewal of the land lease (change in ownership pursuant to section 61(b)) improvements classified as possessory interests are subject to reappraisal, whereas improvements that the lessee (or permittee) retains ownership of in fee simple or in a life estate are not subject to reappraisal because there is no change in ownership of the improvements.

[13] In the realm of property assessment, when someone refers to a "possessory interest," the person almost always means a taxable possessory interest as that term is defined in Rule 20 and not "possessory interest" in its general legal sense. In this manual, unless the context clearly indicates otherwise, "possessory interest" means "taxable possessory interest" as that term is defined in Rule 20.

The remainder of Rule 20 provides definitions for several of the key terms that appear in the general definition described above. The rule defines "possession" and the four criteria cited in the rule: "independence," "durability," "exclusivity," and "private benefit."

Possession. Rule 20 defines "possession" as meaning actual physical occupation. Thus, possession requires more than incidental benefit from the public property; it requires actual physical occupation of the property pursuant to rights not granted to the general public. The rule further defines "right to the possession" or "a claim to a right to the possession" as meaning a right to or a claim to a right to actual physical occupation.

Independence. Under Rule 20, a possession, a right to possession, or a claim to a right to possession is independent if it is "sufficiently autonomous to constitute more than a mere agency." In other words, if the possessor acts as an agent of the public owner, the public owner's immunity or exemption from taxation extends to the possessor's activities, and there is no taxable possessory interest. Although not one of the original *Kaiser* criteria, the independence criterion is derived from them.

To constitute more than a mere agency, in the language of the rule, "the possessor must have the right and ability to exercise significant authority and control over the management or operation of the real property, separate and apart from the policies, statutes, ordinances, rules, and regulations of the public owner of the real property." In general, independence may be measured by the amount of routine control and supervision enjoyed by the possessor, recognizing that the government necessarily retains ultimate control.[14]

> Example: The control of an airport runway or taxiway by the Federal Aviation Administration (FAA) or another government agency or its agent is so complete that it precludes the airlines from exercising sufficient authority and control over the management or operation of the runways or taxiway and does not constitute sufficient "independence" to support a possessory interest.

Durability. The durability criterion derives directly from the *Kaiser* requirement that a taxable possessory interest have a "determinable," or "ascertainable," period of possession or anticipated possession. As defined in Rule 20:

> "Durable" means for a determinable period with a reasonable certainty that the possession of the real property by the possessor, or the possessor's right or claim with respect to the possession of the real property, will continue for that period.

[14] An agent is one who represents another in dealings with third persons, and the existence of an agency relationship is a question of fact. (California Civil Code section 2295; Witkin *Summary of California Law. 9th*, "Agency and Employment," Section 3.) "[W]hether an agency relationship has been created or exists is determined by the relation of the parties as they in fact exist by agreement or acts and the primary right of control is particularly persuasive." (*Pagan v. Spencer* (1951) 104 Cal.App.2d 588, 592- 593.) Factors to be considered to determine if an independent contractor is acting as an agent include the following: (i) whether the principal and agent are engaged in distinct occupations; (ii) the skill required to perform the agent's work; (iii) whether the principal supplies the workplace; (iv) whether the work is part of the principal's regular business; and (v) whether the parties intended to create an agency relationship. (*Ibid*.)

There is no minimum time period, or duration, required to establish durability; the interest must only last for a "determinable" period to satisfy the standard. A month-to-month tenancy can satisfy the durability requirement.[15] In addition, several cases have held that even though a right in publicly owned real property may be revocable or terminable at the option of the government under a lease or contract provision, such a provision is not relevant to whether the right constitutes a taxable possessory interest; rather, it is relevant only to the issue of valuation.[16]

Exclusivity. "Exclusivity" is defined in subsection (c)(7) of Rule 20:

> "Exclusive of rights held by others in the real property" means the enjoyment of an exclusive use of real property, or a right or claim to the enjoyment of an exclusive use together with the ability to exclude from possession by means of legal process others who may interfere with that enjoyment.

In the context of what constitutes a possessory interest, "exclusivity" is not limited to possession by a single individual or entity against all the world. As interpreted by case law, and subsequently codified, a possession of real property that is concurrent with that of another party or parties may still be exclusive. In addition, in order to meet the exclusivity standard, a possessory interest need not provide an exclusive right to provide products or services, only a sufficiently exclusive right to possess real property.

Rule 20 cites the following types of uses of real property, as well as rights and claims to such types of uses, as satisfying the criterion of exclusivity:

1. Sole possession, occupancy, or use of real property.

2. Possession, occupancy, or use of real property as a co-tenant or a co-owner as to leaseholds, easements, profits a prendre, or any other legal or equitable interests in real property of less than fee simple or life estate, where the uses of the co-tenants or co-owners constitute a single use jointly enjoyed.

3. The concurrent use of real property (but not as a co-tenant or co-owner as in 2. above) by a person who has a primary or prevailing right to use the real property and/or to have its designees use the real property.

    Example: A public marina leases boat slips with a lease provision that allows the marina to rent a leased boat slip to a short-term user if the primary lessee is away; subject to the primary lessee's right to exclude the short-term user on the primary lessee's return. Under these facts, the primary lessee has a primary and prevailing right to use the leased boat slip.

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[15] In regard to month-to-month tenancy, see *McCaslin v. DeCamp* (1967) 248 Cal. App. 2d 13.

[16] Beginning, in fact, with *Kaiser Co., Inc. v. Reid* (1947) 30 Cal.2d 610. See also *Lucas v. County of Monterey* (1977) 65 Cal.App.3d 947,956; *Board of Supervisors* (1971) *v. Archer* 18 Cal.App.3d 717; and *United States of America v. County of Fresno* (1975) 50 Cal.App.3d 633.

Example: For purposes of this subdivision, concurrent use of real property demonstrating a primary or prevailing right also includes alternating uses of the same real property by more than one party, such as the case when certain premises are used by a professional basketball team on certain days of each week while a professional hockey team uses the same premises on certain other days.

4. Concurrent uses of real property (but not as co-tenants or co-owners as in 2. above) making qualitatively different uses of the real property.

Examples of "qualitatively different" uses: (1) those by persons making different kinds of uses of the same real property, such as the case when one person is developing mineral resources on real property while others are concurrently enjoying recreational uses on the same real property; and (2) those where different persons have the right to concurrently enter onto and take different things from the same real property.

5. Concurrent uses of real property (but not as co-tenants or co-owners as in 2. above) engaged in qualitatively similar uses that diminish the quantity or quality of the real property.

Examples of uses that diminish the quantity or quality of the real property: (1) grazing cattle; (2) mining; (3) the extraction of oil or gas; and (4) the extraction of geothermal energy.

6. Concurrent uses of real property (but not as co-tenants or co-owners as in 2. above) that do not diminish the quantity or quality of the real property, provided that the number of concurrent use grants is restricted. "Concurrent use grants" include grants, permits, deeds, agreements, and other documents that provide rights to the concurrent use of real property. The number of concurrent use grants is "restricted" when the number is limited by law or by the policies or management decisions of the public owner of the real property or other public agency.

Example: Commercial rafting outfitters have a county use permit to commercially operate on a river. While any private recreational user may raft on the river without limitation or regulation, only approximately 80 commercial rafting outfitters are presently allowed to operate under permit on the river. The commercial rafting outfitters' use of the river is exclusive for purposes of this regulation since the number of commercial use permits issued by the county to commercial rafting outfitters is restricted, regardless of whether or not the commercial rafting outfitters' use of the river diminishes its quantity or quality.

Example: X operates a shuttle van service, picking up passengers at their homes and other locations and transporting them to the airport. When the shuttle van reaches the airport, it utilizes the public street which surrounds the airport to drop passengers off at the various terminals at the airport. The street around the airport is available to all licensed drivers, for commercial and noncommercial uses. Neither the traffic laws, nor

> the policies or management decisions of the public owner of the airport facility restrict the number of users of the public street. In addition, under the assumed facts of this hypothetical, X's use of the public street surrounding the airport does not diminish the quantity or quality of the real property.
>
> Given that (i) the shuttle vans using the public street are making qualitatively similar uses of that real property; (ii) there are no facts indicating that the quality or quantity of the real property is being diminished; and (iii) the number of users of the real property is not restricted, X's right to use the public street surrounding the airport is not exclusive, and X does not have a possessory interest in the public street surrounding the airport.

Private Benefit. The private benefit criterion was one of the original requirements in *Kaiser*, and in recent history, it perhaps has been the dominant factor in judicial analyses of what constitutes a taxable possessory interest. Private benefit is defined in subsection (c)(8) of Rule 20:

> "Private benefit" means that the possessor has the opportunity to make a profit, or to use or be provided an amenity, or to pursue a private purpose in conjunction with its use of the possessory interest. The use should be of some private or economic benefit to the possessor that is not shared by the general public. The fact that a possession of real property is not for a business or commercial purpose or that the possessor is a non-profit corporation does not preclude the possessor from being found to have received a "private benefit" from that possession.

The requirement of private benefit is met if there is an opportunity for the holder of the possessory interest to make a profit; significantly, however, as the above definition indicates, the absence of an opportunity to make a profit does not necessarily mean that the requirement of a private benefit is not met. The scope of "private benefit" is broad. If the possession or use confers some amenity, or allows the pursuit of some private purpose, economic or otherwise, that is not available to the public at large, courts have generally deemed the requirement for private benefit satisfied.[17]

In summary, consistent with the criteria discussed above and the meaning of Rule 20, the private possession of publicly owned real property is taxable only if the possessor (1) physically occupies or holds either the right to physically occupy or the claim to the right to physically occupy the subject real property; and (2) such occupation, right to occupation, or claim to the right of such occupation is independent, durable, exclusive, and confers a private benefit upon the possessor.

[17] See *Wells Natl. Service Corp. v. County of Santa Clara* (1976) 54 Cal.App.3d 579,585; *Rand Corp. v. County of Los Angeles* (1966) 241 Cal.App.2d 585; and *City of San Jose v. Carlson* (1997) 57 Cal.App.4th 1348,1359-60, for discussion of private benefit.

SPECIAL CASES REGARDING WHAT CONSTITUTES A TAXABLE POSSESSORY INTEREST

PERSONAL PROPERTY

Beginning with the first possessory interest statute in 1895 down to present section 107, the statutory definition of a possessory interest has always been limited to interests in land and improvements, that is, to interests in real property. Several counties, however, did not interpret this as precluding possessory interests in personal property, and such interests were assessed.

In 1943, in *Douglas Aircraft Co. v. Byram*, a California appellate court ruled for the first time on the question of whether or not there could be a taxable possessory interest in tax-exempt personal property.[18] A contractor for the federal government possessed work-in-process and inventories that had been assessed as possessory interests. The court held that no possessory interest existed in the property, stating that the property had none of the characteristics of property for tax purposes "judged by any standard of which we have knowledge" and that the contractor was exercising no "usufructuary right."

The court noted, however, that its decision was not based on section 107 [of the California Revenue and Taxation Code], which confined taxable possessory interests to real property only, since the section had not taken effect until after the taxes in issue had become a lien, and several counties continued to assess possessory interests in personal property.

In 1957, the issue was again litigated in *G. G. Moore & Co. Engineers v. Quinn*.[19] Private contractors working for several municipalities possessed component parts of boiler plants that were not yet fabricated into the finished product. Possessory interest assessments were levied against the property. The court held that since legal title or beneficial ownership had passed in all cases to the exempt public agencies, there was no taxable possessory interest in the property.

Finally, in 1958, the California Supreme Court handed down a decision in *General Dynamics Corp. v. Los Angeles County* that proved to be definitive.[20] The court held that the state must have a specific statute authorizing the assessment of possessory interests in personal property in order for such assessments to be valid, stating that "[t]he legislature has not defined personal property as including a right to its possession as it has real property." Subsequent legislative efforts to obtain a statute that authorizes the taxation of possessory interests in personal property have been unsuccessful.

The one exception, alluded to above in Chapter 1, is found in section 201.5. Under that section, taxable possessory interests in property acquired by or for the California Pollution Control Financing Authority, whether in real or personal property, are subject to taxation. The California Pollution Control Financing Authority provides financing for pollution control facilities to assist

[18] *Douglas Aircraft Co. v. Byram* (1943) 57 Cal.App.2d 311.
[19] *G. G. Moore & Co. Engineers v. Quinn* (1957) 149 Cal.App.2d 666.
[20] *General Dynamics Corp. v. Los Angeles County* (1958) 51 Cal.2d 59.

private entities in meeting state environmental standards. This is the only case in which a taxable possessory interest may exist in personal property.

FIXTURES

"Fixture" is defined in Rule 122.5:

> A fixture is an item of tangible property, the nature of which was originally personalty, but which is classified as realty for property tax purposes because it is physically or constructively annexed to realty with the intent that it remain annexed indefinitely.

Thus, a fixture is an item of personal property that, if certain criteria are met, becomes real property. As real property, and assuming the criteria for a taxable possessory interest are met, a taxable possessory interest may exist in a fixture. [21]

NATURAL RESOURCE PROPERTY

Specific legal provisions prescribe assessment methods for certain types of "natural resource" property—oil and gas, mining, and geothermal—that may constitute taxable possessory interests but are assessed under such provisions. Specifically:

- Subdivision (b) of section 107 excludes leasehold estates "for the production of gas, petroleum and other hydrocarbon substances … and other rights relating to these substances which constitute incorporeal hereditaments or profits a prendre" from classification as taxable possessory interests for assessment purposes.
- Rule 468 prescribes a specific method for the assessment of oil and gas producing property.
- Sections 107.2 and 107.3 prescribe a specific assessment method for "certain oil and gas interests" that is analogous to the pre-*De Luz* assessment method (discussed below) for certain possessory interests prescribed in section 107.1. Rule 27 clarifies and interprets the provisions of sections 107.2 and 107.3.
- Rule 469 prescribes a specific method for the assessment of mining property—that is, for "the rights to explore, develop and produce minerals, other than oil, gas and geothermal resources, and the real property associated with these rights."
- Finally, Rule 473 prescribes a specific method for the valuation of geothermal property.

The assessment of these types of properties is not addressed in this manual. When assessing these types of properties, the appraiser should refer to the statutory and regulatory provisions that apply and to applicable sections of the *Assessors' Handbook*.[22]

[21] Sections 104 and 105 also work together to define fixtures as real property. Under section 104, real property is defined to include land and improvements. Section 105 then defines improvements to include "all buildings, structures, fixtures, and fences erected on or affixed to the land." The subject of fixtures is addressed in Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures*.

FEDERAL ENCLAVES

A "federal enclave" is land to which the United States of America claims exclusive jurisdiction, including jurisdiction over all forms of taxation. Under the United States Constitution, article 1, section 8, clause 19, Congress is empowered as follows:

> To exercise exclusive Legislation in all Cases whatsoever…over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards and other needful Buildings.…

This constitutional provision has been held to invalidate state and local taxes imposed on property in federal enclaves.

Whether or not federal lands are located in a federal enclave, thus proscribing state or local property taxation, may depend upon the date on which the federal government acquired the lands. Prior to 1939, cessions of property from California to the federal government for military purposes did not reserve the power of taxation to the state. In 1939, the state statutorily reserved (in the predecessor of current subdivision (e) of section 126 of the Government Code) the power of taxation as to all later transfers. Thus, in general, a taxable possessory interest may exist in property ceded by the state to the federal government after 1939, but a taxable possessory interest cannot exist, in the absence of express congressional authorization, in property ceded from the state to the federal government prior to 1939.[23]

INDIAN LANDS

In general, real property located on an Indian reservation or real property otherwise held in trust by the U.S. Government for Indians or Indian tribes is nontaxable. If the possessor is a non-Indian, however, a taxable possessory interest in Indian lands will exist if the criteria for establishing a taxable possessory interest are satisfied.[24]

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[22] The valuation of oil and gas property and mining property is addressed in Assessors' Handbook Section 566, *Assessment of Petroleum Properties*, and Assessors' Handbook Section 560, *Assessment of Mining Properties*.

[23] Information concerning when state lands were ceded to the federal government can be obtained from the State Lands Commission.

[24] See *Agua Caliente Band of Mission Indians v. County of Riverside* (9th Cir. 1971) 442 F. 2d 1184 and *Fort Mojave Tribe v. County of San Bernardino* (9th Cir. 1976) 543 F. 2d 1253; *Palm Springs Spa. Inc. v. Riverside County* (1971) 18 Cal.App.3d 372.

EXAMPLES OF TAXABLE POSSESSORY INTERESTS

The following is a listing of types of private interests in publicly owned real property that have been found, under certain factual circumstances, to constitute taxable possessory interests. The listing is not all inclusive.

TYPE OF PRIVATE POSSESSION	CITATION
Airport car rental counter space and other leased areas of car rental companies	*County of Los Angeles v. County of Los Angeles AAB No. 1* (1993) 13 Cal.App.4th 102
Amusement machine concession	*Freeman v. Fresno County* (1981) 126 Cal.App.3d 459
Berthing and use of related facilities at public harbors and marinas	*Euro-Pacific v. Alameda County* (1992) 11 Cal.App.4th 891; *Lucas v. County of Monterey* (1977) 65 Cal.App.3d 947; *Sea-Land Service, Inc. v. Alameda County* (1974) 36 Cal.App.3d 837; *Seatrain Terminals of California, Inc. v. Alameda County* (1978) 83 Cal.App.3d 69
Commercial rafting operation	*Scott-Free River Expeditions, Inc. v. El Dorado County* (1988) 203 Cal.App.3d 896
Convention facilities used on a short-term, recurrent (two or more times) basis	*City of San Jose v. Carlson* (1997) 57 Cal.App.4th 1348
Employee-occupied residence on national forest lands	*United States v. Fresno County* (1975) 50 Cal.App.3d 633
Federal shipyard for the construction of ships	*Kaiser Co., Inc. v. Reid* (1947) 30 Cal.2d 610
Food and drink concession at stadium	*Stadium Concessions, Inc. v. City of Los Angeles* (1976) 60 Cal.App.3d 215; *Service America Corporation v. San Diego County* (1993) 15 Cal.App.4th 1232
Ground leases provided to faculty for residential purposes on land owned by a state university	*Connolly v. Orange County* (1992) 1 Cal.4th 1105
Grazing of livestock on national forest lands	*Board of Supervisors v. Archer* (1971) 18 Cal.App.3d 717; *Dressler v. Alpine County* (1976) 64 Cal.App.3d 557; *El Tejon Cattle Co. v. San Diego County* (1966) 64 Cal.2d 428
Lease held by a non-Indian in real property held in trust by the federal government for the benefit of reservation Indians	*Fort Mojave Tribe v. San Bernardino County* (1976) 543 F.2d 1253, cert. den. 430 U.S. 983

TYPE OF PRIVATE POSSESSION	**CITATION**
Leased land that is improved, then leased back to a city in a lease-leaseback transaction	*City of Desert Hot Springs v. Riverside County* (1979) 91 Cal.App.3d 441
Rental of television sets to patients in a county hospital	*Wells National Services Corporation v. Santa Clara County* (1976) 54 Cal.App.3d 579
Rights in real property associated with a cable television franchise	*Cox Cable San Diego, Inc. v. San Diego County* (1986) 185 Cal.App.3d 368; *Stanislaus County v. Assessment Appeals Board* (1989) 213 Cal.App.3d 1445
Single-family residence owned by an irrigation district and occupied by a district employee	*McCaslin v. DeCamp* (1967) 248 Cal.App.2d 13
Snack bar at a golf course clubhouse	*Mattson v. Contra Costa County* (1968) 258 Cal.App.2d 205.
Stationary vessel permanently affixed and used as a restaurant	*Specialty Restaurants Corporation v. Los Angeles County* (1980) 111 Cal.App.3d 607

The following is a listing of types of private interests in publicly owned real property that have been found, under certain factual circumstances, not to constitute taxable possessory interests. The listing is not all inclusive.

TYPE OF PRIVATE POSSESSION	**CITATION**
Dwelling units provided to military personnel	*United States v. Humboldt County* (1980) 628 F.2d 549
Employee-occupied living quarters at the exempt property of colleges and hospitals that is reasonably necessary to the exempt purposes	*English v. County of Alameda* (1977) 70 Cal.App.3d 226
Management and operation of conference facilities	*Pacific Grove-Asilomar Operating Corp. v. Monterey County* (1974) 43 Cal.App.3d 675
Nonexclusive right to use airport real property in common with the general public	*County of Los Angeles v. County of Los Angeles AAB No. 1* (1993) 13 Cal.App.4th 102
Student-occupied residences on university-owned real property	*Mann v. County of Alameda* (1978) 85 Cal.App.3d 505

CHAPTER 3: VALUATION OF TAXABLE POSSESSORY INTERESTS

This chapter discusses the valuation of taxable possessory interests. The chapter begins with a discussion of a few general concepts related to the valuation of taxable possessory interests and then discusses each of the specific taxable possessory interest valuation approaches. The valuation of taxable possessory interests is primarily addressed in Rule 21. [25]

There are also several statutory provisions that apply to specific types of taxable possessory interests such that, if the assessor follows the prescribed valuation method, the assessment retains the presumption of correctness; conversely, if the prescribed method is not followed, the assessment's assumption of correctness is lost. These statutes are discussed in Chapter 5.

GENERAL CONCEPTS

STANDARD OF VALUE

General. Under section 1 of article XIII of the California Constitution (and considered in conjunction with the provisions of article XIII A ["Proposition 13"]), all property is taxed according to its "full value," meaning its fair market value, unless an alternative standard of value is constitutionally prescribed. There is no special standard prescribed for most types of taxable possessory interests; therefore, the standard of value for the assessment of taxable possessory interests generally is fair market value, the same standard that generally applies to all other taxable property.[26]

The applicability of the market value standard to taxable possessory interests also was made clear by the California Supreme Court in *De Luz Homes, Inc. v. County of San Diego*:

> The standard of "full cash value" applies equally to a leasehold [i.e., taxable possessory] interest. Accordingly, the assessor must estimate the price a leasehold would bring on an open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other. He must therefore capitalize, not the anticipated net earnings of the present lessee, but those of a prospective assignee.

The precise definition of fair market value for assessment purposes is found in section 110:

> "[F]air market value" means 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

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[25] Rule 21 was significantly revised in the year 2002. Existing Rules 21, 23, 24, 25, and 26, each of which had addressed separate aspects of taxable possessory interest valuation, were combined into new Property Tax Rule 21, which addresses taxable possessory interest valuation in a single rule.

[26] The taxable possessory interests addressed in section 107.1—that is, "pre-*De Luz*" taxable possessory interests—are an exception. Under section 107.1, the full cash value of a pre-*De Luz* taxable possessory interest is the "excess value" of the lease on the open market. Pre-*De Luz* taxable possessory interests are discussed shortly.

> both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes.

The value of the possessory interest is typically best seen as the fair market value of the rights held by the possessor.

Market value and highest and best use. When estimating a property's fair market value, the appraiser generally presumes that the property is put to its highest and best use. The highest and best use is that use, among possible alternative uses, that is physically possible, legally permissible, and economically feasible. The highest and best use produces the greatest long-term economic return to the land.

When estimating the fair market value of a taxable possessory interest, the appraiser must expect that the possessory interest will be put to one of its permitted uses—that is, the use authorized by the public owner. The permitted use defines the rights held by the possessor, which, for a taxable possessory interest, are the possessor's only taxable rights in the property. In effect, when valuing a taxable possessory interest the highest and best use of that possessory interest is always its permitted use, which is not necessarily the same highest and best use as the fee interest.

Purchase price presumption not applicable. Subdivision (b) of section 110 establishes a rebuttable presumption that full cash value, or fair market value, is the purchase price if the sale was negotiated at arms length between a knowledgeable transferor and transferee neither of which is able to take advantage of the exigencies of the other. The statute, however, specifically states that the purchase price presumption does not apply to sales of taxable possessory interests.

In the case of taxable possessory interests, the purchase price does not include the entire interest that is being valued, and, for this reason, the purchase price presumption cannot be applied. As we discuss in detail below, the sale price of a taxable possessory interest represents only the equity value of the taxable possessory interest. Thus, the purchase price must be adjusted (for any unpaid rent for the reasonably anticipated term of possession) in order to arrive at the value of the entire taxable possessory interest.

REVIEW OF PROPERTY INTERESTS

As briefly discussed in Chapter 1, when a possessory interest is created, the bundle of rights that constitute the fee simple interest is divided into a possessory interest (or interests) and a nonpossessory interest (or interests). For example, in the creation of a lease, the fee simple interest is divided into the leasehold interest (i.e., the possessory interest) and the leased fee interest (i.e., the nonpossessory interest). By paying rent, the holder of the leasehold interest, the lessee, obtains the right to possess the property under the terms and conditions specified in the lease. In exchange for giving up the right to possess the property during the term of the lease, the holder of the leased fee interest, the lessor, obtains the right to receive rent during the term of the lease and the right to the reversion, that is, the right to regain possession of the property at lease termination.

The "value of the leased fee interest" is the sum of the present value of the contract rents over the remaining term of possession under the lease and the present value of the reversionary interest at lease termination, that is, the present value of the right to possess and control the property when the lease terminates. The value of the leased fee interest generally is not relevant to possessory interest valuation.

The term "value of the leasehold interest" (or "leasehold value") can be interpreted in two ways. On the one hand, it may refer to the value of the leasehold interest to a prospective lessee; that is, the present value of the market (i.e., economic) rent for the remaining term of the leasehold interest. Stated slightly differently, it is the amount a prospective lessee would pay for the subject leasehold interest if he or she prepaid the future rents at the market rental rate.[27]

On the other hand, the "value of the leasehold interest" may refer to what is called the "equity value," "bonus value," or "leasehold advantage" in the leasehold interest. This value is based on the present value of the difference between the current market rent and the contract rent, which could be a positive or negative amount. If the contract rent for the remaining term of the lease is below the expected future market rent, the equity value is positive; if the contract rent is above the market rent, the equity value is negative. To avoid confusion, it is perhaps helpful to use the term "full value of the leasehold interest" to refer to the first meaning of "value of the leasehold interest" and the term "equity value of the leasehold interest" to refer to the second meaning.

Using these terms, the value that is sought when assessing a taxable possessory interest, what we have termed the "full value of the leasehold interest," is equal to any of the following:

1. The present value of the economic rents (reduced by any allowed expenses paid from the market rent by the public owner) for the rights possessed as if owned in perpetuity over the remaining term of the lease.

2. The present value of the future contract rents (reduced by any allowed expenses paid from the contract rent by the public owner) for the rights possessed as if owned in perpetuity over the remaining term of the lease, plus what we have called the positive or negative "equity value of the leasehold interest."

3. The value of the rights possessed as if owned in perpetuity minus the present value of the reversionary interest (i.e., the estimated present value of the land and improvements at the termination of the lease).

These relationships form the conceptual basis for the various taxable possessory interest valuation approaches.

Although a taxable possessory interest created by a lease—that is, a leasehold interest—is a common form of taxable possessory interest, a taxable possessory interest can be created in many ways that do not require the execution of a lease, or, for that matter, any written agreement. The

[27] Please see discussion of reasonably anticipated term of possession beginning on page 21.

concepts and terms used above in the context of a lease can be generalized to refer to other types of property relations that also constitute taxable possessory interests.

PRE- AND POST-*DE LUZ* TAXABLE POSSESSORY INTERESTS

***Blinn* Method.** In 1932, in *Blinn Lumber Co. v. Los Angeles County*, a case that concerned the valuation of a leasehold interest in publicly owned tidelands, the California Supreme Court provided the first guidance to assessors regarding the valuation of taxable possessory interests.[28] The *Blinn* court considered the three generally accepted valuation approaches and decided that the income approach was the most appropriate approach given the facts before it. To estimate the value of the subject taxable possessory interest, the court discounted (i.e., calculated the present value of) the lessee's imputed net income (i.e., not the actual income) over the remaining term of the leasehold. However, in developing the imputed net income, the court allowed the deduction of the rent paid by the possessor.

By allowing the deduction for rent paid, the *Blinn* method of valuation restricted the value of the taxable possessory interest to (at most) the lessee's equity value, or bonus value, in the leasehold interest. In other words, it restricted the value of the taxable possessory interest to (at most) the present value of the difference between the market (economic) rent and the contract rent. In general, assessors adhered to the *Blinn* method until 1955.

***De Luz* Method.** The next significant development in the valuation of taxable possessory interests occurred in 1955 in *De Luz Homes, Inc. v. County of San Diego*.[29] *De Luz* involved a military housing project constructed on a United States military reservation in San Diego County (there were also companion cases from Solano, San Bernardino, and Orange Counties). Ownership of the improvements passed to the United States on completion of construction; the federal government then contracted with a private party for the long-term operation and management of the project. San Diego County (as did the other counties in the companion cases) assessed the leasehold interest as a taxable possessory interest.

In *De Luz*, the California Supreme Court reversed itself, disapproving the method of valuation it had previously set forth in *Blinn*. As noted, *Blinn* had allowed the lessee to deduct his rental payments and some other costs when calculating the net income to be capitalized. In *De Luz* (and the companion cases), the lessee had claimed deductions that also included the amortization of the investment in improvements in addition to the land rent. The effect was to reduce the net income to be capitalized, and hence the estimated value of the taxable possessory interest, to practically zero.

The *De Luz* court held that in valuing a taxable possessory interest by the capitalization of income method, it was improper to deduct the lessee's charges for rent, amortization of investment, or payment of principal or interest on mortgage debt from the estimated gross return in developing the net income to be capitalized. Essentially, the court held that such deductions were part of the "purchase price," or "full cash value," of the property and should not be allowed because the result

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[28] *Blinn Lumber Company v. County of Los Angeles* (1932) 216 Cal. 148. Until this case, assessors did not have much guidance in regard to the valuation of taxable possessory interests.
[29] *De Luz Homes, Inc. v. San Diego County* (1955) 45 Cal.2d 546.

was a deviation from the full cash value (or fair market value) standard. Rather, said the *De Luz* court, the assessor should capitalize the market (economic) rent applicable to the property rights held by the lessee, that is, the net income that would be expected by a prospective purchaser of the subject property (in this case, the leasehold interest). As stated by the court:

> The standard of "full cash value" applies equally to a leasehold interest. Accordingly, the assessor must estimate the price a leasehold would bring on an open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other. He must therefore capitalize, not the anticipated net earnings of the present lessee, but those of a prospective assignee. To a prospective assignee, anticipated net earnings equal expected gross income less necessary expenditures for maintenance, operation, and taxes. No deduction is made for the cost of the lease to the present lessee, i.e., his charges for rent and amortization of improvements, for to a prospective assignee the value of a leasehold is measured solely by anticipated gross income less expected necessary expenditures.[30]

Thus, the *De Luz* method captures the full value of the leasehold interest, whereas the *Blinn* method captured only the lessee's equity, or bonus, value. In other words, the value under *De Luz* is equal to the present value of the future market rents under the leasehold (reduced by any allowed expenses of the public owner paid from the market rent).

Section 107.1. The *De Luz* decision became final on December 25, 1955. Obviously, prior to that date many taxpayers had entered into leases under the assumption that their possessory interest assessments would be assessed under the *Blinn* method. In 1957, the Legislature attempted to return these parties to their pre-*De Luz* position by enacting section 107.1. As originally enacted, section 107.1 contained two main provisions: (1) the first provision declared taxable possessory interests to be personal property, opening the possibility that the Legislature might exempt them from taxation entirely (the Legislature has had the power to classify and exempt personal property since 1933); and (2) the second provision recognized the *De Luz* method as the correct method for valuing taxable possessory interests. For leases entered into prior to *De Luz* (i.e., prior to December 25, 1955), however, section 107.1 defined the full cash value for assessment purposes as the present value of the amount by which the market (economic) rent exceeded the contract rent, if any, over the unexpired term of the lease. Thus, section 107.1 restored the valuations of pre-*De Luz* taxable possessory interests to substantially what they would have been under the *Blinn* method.

The constitutionality of section 107.1 was questioned on two grounds. First, taxable possessory interests are real property and exempting real property required constitutional authorization; legislative authorization alone was insufficient. Second, in *De Luz*, the California Supreme Court had held that the *Blinn* method was an illegal departure from the requirement that all property be assessed at its full cash value; therefore, allowing the *Blinn* method to apply to certain taxable

[30] *De Luz Homes, Inc. v. San Diego County, supra,* 45 Cal.2d 546, 566.

possessory interests also seemed to violate the California Constitution. In 1960, these constitutional questions were addressed in *Forster Shipbuilding Co. v. County of Los Angeles*.[31] The *Forster* decision struck down the portion of section 107.1 that had defined a possessory interest as personal property, but upheld the prospective-only application of the *De Luz* method of valuation for possessory interests under the reasoning that it was a reasonable exercise of the Legislature's power to mitigate hardships caused by the overruling of established law.

Thus, for taxable possessory interests created before the *De Luz* decision became final and not since extended or renewed, the *Blinn* method of valuation applies; these taxable possessory interests typically are called "pre-*De Luz* taxable possessory interests." For taxable possessory interests created, extended, or renewed after the *De Luz* decision became final, the *De Luz* method of valuation applies; these taxable possessory interests typically are called "post-*De Luz* taxable possessory interests." The vast majority of taxable possessory interests are post-*De Luz*. However, pre-*De Luz* taxable possessory interests still exist, some with significant values.

TERM OF POSSESSION

In General. Perhaps the cardinal feature of a taxable possessory interest is that it is an interest of finite duration. At some future date, the interest of the private possessor will terminate, and possession of the property will revert to the public owner. The "term of possession" is the measure of a taxable possessory interest's duration.

When valuing a taxable possessory interest, the appraiser must determine a term of possession for the interest. Directly or indirectly, a term of possession is required in each of the methods for valuing a taxable possessory interest. The term of possession also affects the value of a taxable possessory interest. All else being equal, the longer the term of possession, the higher the value of the possessory interest.

Reasonably anticipated term of possession. Rule 21 defines the "term of possession for valuation purposes" as the "reasonably anticipated term of possession." The reasonably-anticipated standard applies to all taxable possessory interests regardless of the type of real property or form of tenancy (e.g., month-to-month, long-term, or some other type of relationship).

As stated in subsection (d)(1) of the rule, "[t]he stated term of possession shall be deemed the reasonably anticipated term of possession unless it is demonstrated by clear and convincing evidence that the public owner and the private possessor have reached a mutual understanding or agreement, whether or not in writing, such that the reasonably anticipated term of possession is shorter or longer than the stated term of possession."

Rule 21 defines "stated term of possession" of a taxable possessory interest on the valuation date as the remaining period of possession as specified in the lease or other legal instrument that

[31] *Forster Shipbuilding Co. v. County of Los Angeles* (1960) 54 Cal.2d 450.

created, renewed, or extended the taxable possessory interest (including any option periods if it is reasonable to assume that the option or options will be exercised).[32]

If the assessor successfully demonstrates by clear and convincing evidence that the public owner and the possessor have reached a mutual understanding or agreement such that the reasonably anticipated term of possession differs from the stated term of possession, the term of possession for valuation purposes is the stated term of possession as modified by the terms of the mutual understanding or agreement. The conduct must prove by clear and convincing evidence that there is a mutual understanding or agreement between the parties. For example the sole fact that the possessor has made substantial improvements in anticipation that the term will be extended does not necessarily mean that the reasonably anticipated term will include the extended period until there is an actual mutual understanding or agreement that the term will be extended. The reasonably anticipated term of possession so demonstrated may be longer or shorter than the state term of possession.

Also under Rule 21, certain taxable possessory interests are deemed to not have a stated term of possession, such as those created by month-to-month leases or agreements. The presumption regarding stated term of possession does not apply to these taxable possessory interests. Examples of such taxable possessory interests include taxable possessory interests that run from month-to-month, taxable possessory interests without a fixed term, and taxable possessory interests of otherwise unspecified duration.[33]

For taxable possessory interests that are without stated terms of possession, the assessor should determine a term of possession on each valuation date using the criteria for the reasonably anticipated term of possession listed below, together with other relevant criteria.

As stated in subsection (d)(2) of the rule, "[i]f there is no stated term of possession, the reasonably anticipated term of possession shall be demonstrated by the intent of the public owner and the private possessor, and by the intent of similarly situated parties using criteria such as the following:

(A) The sale price of the subject taxable possessory interest and sales prices of comparable taxable possessory interests.

(B) The rules, policies and customs of the public owner and other similarly situated public owners.

(C) The customs and practices of the private possessor and similarly situated private possessors.

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[32] In *County of Riverside v. Palm-Ramon Development Co.* (1965), 63 Cal. 2d 534, the California Supreme Court upheld the assessor's right to include option periods in the term of possession. An option period should be included in the term, however, only if it is reasonable to assume that the option will be exercised.

[33] Other examples are tenancies at will, tenancies at sufferance, periodic tenancies, and tenancies with an indefinite term.

(D) The history of the relationship of the public owner and the private possessor and the histories of the relationships of similarly situated public owners and private possessors.

(E) The actions of the parties to the subject taxable possession interest, including any amounts invested in improvements by the public owner or the private possessor."

"Terminating" taxable possessory interests. A special case exists when the evidence establishes that at a certain future date the public owner of the real property will no longer make the real property available for private possession. This situation is sometimes called a "terminating taxable possessory interest." If the evidence establishes the existence of a terminating taxable possessory interest, the term of possession on each valuation date should be the anticipated remaining period that the real property will be available for private possession or the reasonably anticipated term of possession, whichever is shorter.

TAXABLE POSSESSORY INTEREST VALUATION METHODS

The valuation approaches for taxable possessory interests are similar to the conventional approaches to value—the comparative sales approach, the income approach, and the cost approach—that are generally accepted and used in the valuation of the fee simple interest. However, the conventional approaches must be modified to accommodate the finite duration of a taxable possessory interest and the corresponding fact that a portion of the fee simple interest in those rights, the reversionary interest, is retained by the public owner and is nontaxable.[34]

A taxable possessory interest may be valued using "direct methods" or "indirect methods." With the direct methods, the appraiser directly estimates the present value of the rights held by the possessor over the reasonably anticipated term of possession. With the indirect methods, the appraiser estimates the value of the rights in the taxable possessory interest as if it were owned in perpetuity (i.e., as if it were owned in fee simple) and subtracts the estimated present value of the nontaxable reversionary rights retained by the public owner, leaving a remainder equal to the value of the taxable possessory interest. The indirect methods thus require estimates of two values: the as-if-owned-in-fee value and the present value of the nontaxable, publicly owned reversion.[35]

There are direct and indirect methods for both the comparative sales and income approaches. The cost approach is a hybrid in the sense that the improvements are valued on the basis of depreciated

[34] The valuation of taxable possessory interests requires familiarity with the concepts and techniques used in the valuation of property in fee simple. See, for example, Assessors' Handbook Section 501, *Basic Appraisal*, and Assessors' Handbook Section 502, *Advanced Appraisal*, or a standard appraisal text.

[35] When using the indirect methods, the nontaxable reversionary value is typically based on the value of all the rights in the publicly owned real property. This does not present a problem if all the rights of economic significance in the property are also contained in the subject taxable possessory interest. However, if there are economically significant rights not contained in the subject taxable possessory interest (for example, if there are multiple, concurrent taxable possessory interests), the estimated present value of the reversion should reflect only the rights contained in the subject taxable possessory interest. Thus, when we say, "subtract the present value of the reversion," we mean, more precisely, "subtract the portion of the value of the reversion that corresponds to the value of the rights held by the possessor."

replacement cost, while the land or site is valued using any of the methods, direct or indirect, applicable to the comparative sales or income approaches.

The valuation methods are very similar for post-*De Luz* and pre-*De Luz* taxable possessory interests. As we shall see, only a relatively minor adjustment is required to convert a post-*De Luz* valuation to a pre-*De Luz* valuation. Most taxable possessory interests are post-*De Luz* taxable possessory interests. Most appraisers, in fact, will never see a pre-*De Luz* taxable possessory interest; there simply are not that many of them that remain in existence.

VALUATION OF POST-*DE LUZ* TAXABLE POSSESSORY INTERESTS

The post-*De Luz* methods include the following:

1. Comparative Sales Approach (Post-*De Luz*)
   - Comparative Sales Approach-Direct Method
   - Comparative Sales Approach-Indirect Method
2. Income Approach (Post-*De Luz*)
   - Income Approach-Direct Method
   - Income Approach-Indirect
3. Cost Approach (Post-*De Luz*)

Comparative Sales Approach (Post-*De Luz*)

Comparative Sales Approach-Direct Method

In the comparative sales approach-direct method, the appraiser uses the sale price of the subject taxable possessory interest and/or the sale price of one or more comparable taxable possessory interests to derive a value indicator. The method involves the following steps:

1. If necessary, adjust the sale price of the subject or comparable for cash equivalence to arrive at a cash equivalent sale price.

2. Add the present value on the sale date of the unpaid contract rent for the reasonably anticipated term of possession (based on the stated term of possession or the stated criteria in Rule 21, as applicable). The contract rent should be reduced by any expenditure necessary to maintain the income from the taxable possessory interest during the possessor's reasonably anticipated term of possession, including any element of "gross outgo" as defined in subsection (c) of Rule 8. Examples of allowable expenses (gross outgo) include but are not limited to, security services, maintenance, administration, trash removal, facility improvements, utility fees, advertising and promotional services.

3. Add the cash equivalent present value on the sale date of any debt obligations assumed by the buyer as part of the transaction (or, as to which, the buyer takes the property "subject to").

4. Add the present value on the sale date of any future contractually required cash expenditures that the buyer will incur that are associated with the possession of the subject property (e.g., site restoration expenditures at the termination of the taxable possessory interest).

5. Subtract the present value on the sale date of any future contractually entitled cash receipts that the buyer will receive associated with the possession of the property (e.g., the salvage value of, or the reimbursement value for, improvements existing at the end of the term of possession).

6. In the case of a comparable taxable possessory interest, the comparable taxable possessory interest should meet the general standards for comparability contained in section 402.5, and the sales prices of the comparable taxable possessory interests should also be adjusted, if necessary, as prescribed in subsections (c) and (d) of Rule 4. That is, the appraiser should make adjustments to the equity sale price of the comparable taxable possessory interest, if necessary, for changes in market conditions ("price level"), relevant physical or economic differences, and differences in permitted uses. An adjustment for cash equivalence, if necessary, should be made initially, as noted above.

Unless all future contract rents have been prepaid, the equity sale price of a taxable possessory interest is an incomplete indicator of its fair market value. If the future contract rents are not prepaid (the typical case), the sale price is only an indicator of the equity value of the leasehold. To arrive at the consideration paid for the taxable possessory interest (i.e., the "full value of the leasehold interest"), the appraiser must add the present value of the unpaid future contract rents (reduced by any allowed expenses paid by the public owner) for the reasonably anticipated term of possession to the cash equivalent equity sale price.

The equity sale price may vary depending on any contractually obligated future costs that are assumed by the buyer. The present value of any significant obligated costs (e.g., site restoration at the end of the term of possession) should be added to the cash equivalent equity sale price of the taxable possessory interest since these costs, like rent, are part of the consideration the lessee pays for the right to possession. Such obligated costs do not include allowable expenses that the public owner pays in order to continue the production of income from the property. For example, janitorial services, security services, advertising and promotion expenses, maintenance and repair, management and administration expenses would not be included.

Conversely, the equity sale price may vary depending on any future contractual benefits received by the buyer that are in addition to the right to possession. The present value of any significant benefits (e.g., the right to salvage the improvements or be reimbursed for the cost of improvements) should be subtracted from the cash equivalent equity sale price, since, presumably, a portion of the purchase price was for these benefits and not for the right to possession.

The following example illustrates the valuation of a taxable possessory interest using the comparative sales approach-direct method:

EXAMPLE 3.1

USING THE COMPARATIVE SALES APPROACH-DIRECT METHOD TO VALUE TAXABLE POSSESSORY INTEREST

Subject taxable possessory interest: the right to possess a cabin in a national forest. For purposes of illustration calculations assume rent payment at the end of the period. Where rents are payable in advance calculations should reflect that fact.

PERTINENT INFORMATION:

- Purchase price: $76,000 (cash)
- Reasonably anticipated term of possession: 20 years
- Annual contract land rent: $1,200
- Allowed expenses paid by the public owner: 3% management, $50 per year road and tree maintenance; total allowable expenses: $86 per year
- Assume that the sale of the subject cabin occurred 2 years ago; market values of comparable cabins have increased about 10% per year since the sale date of the subject cabin; thus, use $15,000 as market conditions adjustment.
- Capitalization (discount) rate used to discount future contract rent, exclusive of property taxes: 12% (It is not necessary to add a property tax component to the discount rate because the possessor will pay the possessory interest taxes.)

The sale price of the subject property itself is used to derive the value indicator: thus, no adjustment for comparability is required. Accordingly, the only required adjustments are for market conditions and the present value of unpaid future contract rent. If this sale were used as a comparable in the valuation of another subject property, the adjustment for market conditions might be different, and an additional adjustments for property attributes (i.e., the comparable vis-a-vis the subject property) also might be necessary.

Equity Sale Price of Subject:	$76,000	
Market Conditions Adjustment:	15,000	
Add Present Value of the Contract Rent		
($1,200 less $86 = $1,114/yr. for 20 yrs. @ 12%)		
PV$1PP (annual)/20 yrs./12% = 7.47		
$1,114 x 7.47	8,321	
Adjusted Sale Price:	$99,321	
Indicated Value of Subject:	$99,321	Say, $99,500

* Although there were no such adjustments in this example, the present value of any obligated costs of the buyer, such as site restoration at the end of possession, should be added to the equity sale price. Such costs, like the future contract rent, are part of the lessee's full cost of possession.

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Comparative Sales Approach-Indirect Comparison Method

In the comparative sales approach-indirect comparison method, the appraiser derives a value indicator using the estimated value of the subject taxable possessory interest as if it were owned in fee and the estimated value of the nontaxable, publicly owned reversion. This method involves the following steps:

1. The appraiser estimates the value of the subject taxable possessory interest using comparable sales of the fee-owned properties. That is, the assessor first estimates the value of the taxable possessory interest as if it were privately owned in fee simple using the "conventional" comparative sales approach. As with the comparative sales approach-direct method, the comparable sales properties should meet the standards for comparability contained in section 402.5, and the comparable sales prices should be adjusted, if necessary, in accord with Rule 4. The highest and best use of the comparable fee-owned properties must correspond to the permitted use of the subject taxable possessory interest.

2. The appraiser then subtracts the estimated present value of the nontaxable reversionary interest from the as-if-in-fee value.[36]

Reversionary rights to be valued. In estimating the as-if-in-fee value, only the rights to possession held by the possessor are valued; correspondingly, in estimating the present value of the reversion only the value of those same rights should be estimated and subtracted from the as-if-in-fee value. The reversionary rights (i.e., the rights that revert to the public owner at the termination of the subject taxable possessory interest) are sometimes less than the full unrestricted rights to possess the property (e.g., if there are concurrent taxable possessory interests). In a strict legal sense, "reversion" typically refers to the full unrestricted rights in a property; we use "reversion," however, to refer only to the rights contained in the subject taxable possessory interest. By doing so, we avoid the problem of having to value rights not held by the possessor when estimating the as-if-in-fee value.

Present value of the reversion. An estimate of the present value of the reversionary interest of the rights possessed is required in both the comparative sales approach-indirect method and the income approach-indirect method (discussed below). Estimating the present value of the reversion first requires an estimate of its future value (i.e., the value of the reversionary interest at the end of the reasonably anticipated term of possession); this estimated future value is then discounted to its present value.

In the indirect methods (i.e., comparative sales and income), assuming the subject taxable possessory interest is improved, the as-if-in-fee value generally is estimated using an appraisal unit that includes land and improvements. The same appraisal unit, that is, a unit that comprises

[36] To estimate the present value of the reversion, the appraiser must discount the estimated value of the reversion to its present value. This requires the development of a capitalization, or discount, rate. The development of a discount rate is discussed below (under the income approach). In general, that discussion also applies to the development of the capitalization rate used in the indirect approaches. That discussion also addresses the treatment of property taxes in relation to the capitalization rate.

land and improvements normally should be used when estimating the present value of the reversion. Even though the appraisal unit may comprise land and improvements, however, the appraiser may conclude that the improvements will contribute no value on reversion.

The following example illustrates the valuation of a taxable possessory interest using the comparative sales approach-indirect method:

EXAMPLE 3.2

USING THE COMPARATIVE SALES APPROACH-INDIRECT METHOD TO VALUE TAXABLE POSSESSORY INTEREST

Subject taxable possessory interest: the right to possess a ten-unit motel in a state park.

PERTINENT INFORMATION:

- Estimated value as if owned in fee simple: $400,000.
- The appraiser estimates this value using sales data from otherwise comparable fee-owed properties. For example, the appraiser might develop a unit of comparison from the comparable sales based on sale price per unit or might develop a gross rent multiplier.
- Reasonably anticipated term of possession: 15 years. (The remaining lease term on the valuation date.)
- Estimated value of the reversion: $720,000.
- Estimated value 15 years hence, given the 15-year reasonably anticipated term of possession. The appraiser estimates that the value of the subject property [land and improvements] will increase at a rate of 4 percent per year, compounded, over the term of possession. ($400,000 x 1.8000 [FV$1/15yrs/4%] = $720,000).
- Capitalization, or discount, rate, used to discount the reversionary value, exclusive of property taxes: 12%.*

Property value as if owned in fee simple	$400,000	
Less: present value of reversion:		
= $720,000 x PV$1/15yrs/12%		
= $720,000 x 0.1827 =	(131,544)	
	$268,456	say, $268,500

* It is not necessary to add a property tax component to the discount rate because the possessor will pay the possessory interest taxes. The development of a capitalization rate and the treatment of property taxes in relation to the capitalization rate is discussed below (with the income approach).

Income Approach (Post-*De Luz*)

Income Approach—General

Income to be Capitalized

General. The income to be capitalized when valuing a taxable possessory interest is the "net return" to the public owner attributable to the taxable possessory interest, which is "gross return" less "gross outgo." As defined in subsection (c) of Rule 8, gross return means any money or money's worth that the taxable property will produce. Gross outgo means any outlay of money or money's worth required to develop and maintain the estimated income. Gross outgo is also referred to herein as allowed expenses.

The income to be capitalized may be based on either rental or operating income. The rental income should reflect the estimated market (economic) rent for the subject taxable possessory interest. Rental income is preferred because operating income may be influenced by managerial skill or derived, in part, from nontaxable property.

With Rental Income. When estimating the income to be capitalized, or net return, from rental income, elements of gross outgo, or allowed expenses, paid by the public owner must be subtracted from the rental income. The amount and type of allowed expenses to be subtracted depends on the structure of the lease or agreement related to the taxable possessory interest.

In a gross lease, all operating expenses, including property taxes, are included in the stated, or contract, rent, and the landlord/public owner pays these expenses from the stated, or contract, rent. Thus, all allowed expenses must be subtracted from a gross rent. In a net lease, most operating expenses, including property taxes, are excluded from the stated, or contract rent, and these expenses are paid by the tenant/private possessor in addition to the stated, or contract, rent. Thus, few expenses must be subtracted from a net rent. Some lease structures are hybrids of these pure forms, with the landlord/public possessor paying specified expenses and the tenant/possessor paying others. In these cases, the amount and type of expenses that must be subtracted from the rental income will vary.

Even with a net lease, however, it may be necessary to subtract some expenses from the net rent. The landlord/public owner must manage and administer the taxable possessory interest and may incur other allowed expenses related to the taxable possessory interest that are not paid by the tenant/possessor and must be paid out of the net rent. The use of comparable rental data based on a lease structure (i.e., gross vs. net) similar to that of subject taxable possessory interest is preferred. Otherwise, the appraiser must adjust the comparable rental data to reflect the lease structure of the subject property.

With Operating Income. When estimating the income to be capitalized, or net return, from operating income, all elements of gross outgo, or allowed expenses, whether paid by the landlord/public owner or by the tenant/possessor, must be subtracted from the gross return. "Gross operating income" and "net operating income" are defined consistent with "gross return" and "net return," respectively, in subsection (c) of Rule 8.

Elements of gross outgo, or allowed expenses, include the following, as applicable: cost of goods sold, typical operating expenses, typical management expense, an allowance for a return on working capital, and an allowance for a return on and a return of the value of any nontaxable property that contributes to the gross operating income.

Typical operating expenses may include expenses for the rental of personal property, for the provision of security services, and for advertising and promotional services, provided such expenses are necessary for the production of the gross income from the subject taxable possessory interest. Typical operating and management expenses include expenses that an owner/operator typically would bear to maintain the property and to continue the production of income from the property but which, in the case of the subject taxable possessory interest, are borne by the public owner.

Gross outgo, or allowed expenses, does not include the following: amortization, depreciation, depletion charges, debt retirement, interest on funds invested in the taxable possessory interest, the contract rent for the taxable possessory interest, property taxes on the taxable possessory interest, income taxes, or state franchise taxes measured by income.

Estimating the Market (Economic) Rent. If rental income is used, the appraiser may estimate the market (economic) rent as of the valuation date using any of the following as indicators, or evidence, of the market rent, as appropriate:

1. The contract rent for the subject taxable possessory interest

2. Contract rents for comparable taxable possessory interests

3. Contract rents for leasehold interests in comparable real property held in fee

4. Contract rents for other comparable interests in real property

Preferably, the contract rents should have been negotiated in a competitive market involving real property reasonably comparable to the subject taxable possessory interest in terms of physical attributes, location, legally enforceable restrictions on the property's use, term of possession, and risk of cancellation of the taxable possessory interest by the public owner. Also, the contract rents should have been negotiated sufficiently near in time to the valuation date as to "shed light" on the economic rent of the subject taxable possessory interest.

When using the contract rent of a taxable possessory interest as an indicator of the market rent, the assessor should add the following to the contract rent:

1. An estimate of the amount, if any, by which the contract rent has been reduced because improvements have been constructed at the possessor's expense that will revert to the public owner at the end of the term of possession

2. An estimate of the amount, if any, by which the contract rent has been reduced because the possessor will bear the cost of restoring the real property to its original condition on reversion to

the public owner, including the cost of removing improvements (less any estimated salvage value of, or reimbursement value for, the improvements), or the cost of any similar obligation

The purpose of both of the above adjustments is to arrive at a rent that reflects the full consideration paid for the right to possess the property. If, in addition to the contract rent, the possessor pays for improvements that will have a significant value at the termination of the taxable possessory interest, the full consideration paid for the possession of the property includes this value, and the contract rent should be adjusted accordingly. Similarly, the full consideration paid for the possession of the property may include significant site restoration costs at the end of the term of possession, less any off-setting salvage value or reimbursements.

Developing the Capitalization Rate

Under subsection (g) of Rule 8, a capitalization rate may be developed either (1) from income and sales data from comparable properties (the "market-derived rate") or (2) by deriving a band of investment (or "weighted average cost of capital") using market rates of return for debt and equity capital, respectively (the "band of investment rate"). Consistent with Rule 8, a capitalization rate for valuing a taxable possessory interest may be developed similarly, using any of the following methods:

1. By comparing the anticipated net incomes from comparable taxable possessory interests with their sales prices stated in cash or its equivalent and adjusted as described in subsection (e)(1)(A).

2. By comparing the anticipated net incomes of comparable fee simple absolute interests in real property with their sales prices stated in cash or its equivalent, provided the comparable fee properties are not expected to produce significantly higher net incomes subsequent to the subject taxable possessory interest's term of possession than during it.

3. By deriving a weighted average of the capitalization rates for debt and equity capital appropriate for the subject taxable possessory interest, weighting the separate rates of debt and equity by the relative amounts of debt and equity capital expected to be used by a typical purchaser of the subject taxable possessory interest.

Also, consistent with subsection (f) of Rule 8, the capitalization rate should include a component for property taxes, where applicable, and as discussed below.

In other words, the appraiser can develop a capitalization rate by using sales and income data from comparable taxable possessory interests or otherwise comparable fee-owned property or by deriving a weighted average of the appropriate rates of return on debt and equity, with the respective weights determined by the typical loan-to-value, or equity-debt, ratio in the market. In essence, "appropriate" means the typical investor's required rates of return on debt and equity on a risk-adjusted basis. That is, the relevant question is the following: what rate of return would a typical buyer of the subject taxable possessory interest require on his or her equity investment in the subject taxable possessory interest and what rate of return would a typical lender require in order to lend?

There are two generic methods of capitalization in real property appraisal: "direct capitalization" and "yield, or annuity, capitalization" (which also encompasses discounted cash flow analysis). In direct capitalization, the value indicator is obtained by dividing a single year's expected net income by a type of capitalization rate that is typically called an "overall rate." An overall capitalization rate is simply the reciprocal of a net income multiplier (i.e., the quotient of the comparable sales price divided by the comparable property's expected annual net income). In yield capitalization, the value indicator is obtained by discounting the subject property's expected net incomes for multiple years over an expected holding period (the reasonably anticipated term of possession in taxable possessory interest valuation); the discounted income also includes any expected reversionary income at the end of the holding period (or reasonably anticipated term of possession). The capitalization rate used in yield capitalization is called a yield rate (or, "interest rate" or "rate of return"). A yield rate is always used in conjunction with a discounting process, that is, in conjunction with annuity factors or the equivalent (e.g., discounted cash flow analysis). Given adequate data, both overall rates and yield rates can be developed using the two techniques prescribed in Rule 8—that is, the market-derived method and the band of investment method, although the application of the techniques is slightly different for the two kinds of capitalization rates.[37]

Whenever multiple incomes are discounted to arrive at a value indicator, the proper method of capitalization is yield capitalization, and the proper capitalization rate is a yield rate, not an overall rate. In order to derive a yield rate from sales data (i.e., "the market-derived" way), the appraiser requires the buyer's expected annual net incomes (including the expected income that results from the reversionary value) over the buyer's expected holding period. This data is very difficult to obtain for sales of fee simple interests and almost impossible to obtain for sales of taxable possessory interests.

In the band of investment, the estimate of the debt return component is relatively straightforward; the appraiser may have access to lender data involving comparable taxable possessory interests, and he or she will almost certainly have access to market loan rates for comparable fee-owed property. It also is not difficult to estimate a typical loan-to-value ratio. The difficult part in the band of investment technique is the estimate of the equity rate of return, about which only limited data is available from fee-owned comparables and practically no data is available from taxable possessory interests. Nonetheless, there are several possible approaches to estimating the equity rate of return:

1. One approach to the estimation of the equity rate of return involves the use of financial market data in conjunction with asset pricing models, such as the capital asset pricing model, but this approach is controversial when the estimates of equity return are used to value real property.[38]

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[37] See Assessors' Handbook Section 502, Chapter 4.
[38] *Ibid*.

2. Another approach involves investor surveys. Certain real estate research organizations periodically survey institutional investors with in regard to their expected rates of return for the types of properties in which they invest (which, generally, reflect fee ownership). For example, a rate of return survey involving institutional investors in hotel properties might provide rate-of-return information applicable to the valuation of a taxable possessory interest involving a hotel. This approach, however, may be open to criticism based on problems of comparability.

3. In yet another approach, an equity rate of return can be estimated by applying a simple equity-over-debt premium. The expected equity rate of return will always be higher than the related debt rate because the equity return is residual to the equity return and is more volatile (i.e., riskier) due to financial leverage. The difficulty here, of course, is estimating exactly what the equity-over-debt premium should be; nevertheless, a "small" equity-over-debt premium arguably is supportable on theory alone (i.e., the higher required rate of return on equity vis-a-vis the debt rate, given the equity position's greater risk).

4. Finally, the appraiser could consider the following relationship:

$$r_o = k_o - g \text{ or}$$
$$k_o = r_o + g,$$

where r_o is the overall capitalization rate, k_o is the yield rate (sometimes designated y_o), and g is the estimated long-term growth rate in the net income attributable to the taxable possessory interest.

This equation relates the overall capitalization rate, r_o, to the yield rate, k_o, given the assumption that in the long-run (technically, in perpetuity), the net income (i.e., the net income attributable to the total property, both debt and equity) grows at a constant rate, g. For example, assume one derives an overall rate from a comparable sale property of 10 percent. If one assumes that, in the long run, the net income from the comparable property (and hence from the subject taxable possessory interest) will grow at 3 percent per year, then the indicated yield rate, k_o, is 13 percent (10 percent + 3 percent).[39]

Property Tax Component and Capitalization Rate

In General. If property taxes will be paid out of the income to be capitalized, a property tax component (typically, the one-percent general property tax rate) should be added to the capitalization rate. Conversely, if property taxes will not be paid out of the income to be capitalized, a property tax component should not be added to the capitalization rate.

When rental income is used, and the income to be capitalized is based on a gross rent (i.e., all operating expenses, including property taxes, are included in the gross rent and are paid by the landlord from the gross rent), property taxes will be paid out of the income to be capitalized (i.e., the gross rent, less allowed expenses), and the capitalization rate should contain a component for

[39] The relationship is based on the formula for a growing perpetuity. The derivation of the formula for a growing perpetuity is covered in most introductory finance and many appraisal texts.

property taxes. When rental income is capitalized, and the income to be capitalized is based on a net rent (i.e., all operating expenses, including property taxes, are excluded from the net rent and are paid by the tenant in addition to [or "outside of"] the net rent), property taxes will not be paid out of income to be capitalized (i.e., the net rent) and the capitalization rate should not contain a component for property taxes.

With most taxable possessory interests, the possessory interest tax is paid by the possessor in addition to rent; this is a standard contractual provision. Assuming that the rental income to be capitalized for the subject taxable possessory interest has been estimated on this basis—that is, using comparable rents that reflect, or have been adjusted to reflect, a lease structure in which the possessor pays the property taxes in addition to rent—the capitalization rate should not contain a property tax component. If the appraiser, however, must estimate the income to be capitalized for the subject taxable possessory interest on a gross basis—that is, using comparable rental data that reflects a lease structure in which the landlord pays the property taxes out of the rent—then the capitalization rate must contain a property tax component.

When operating income is used, property taxes will always be paid out of the income to be capitalized, and the capitalization rate should always contain a component for property taxes.[40]

When discounting reversion. When using the indirect methods of valuing a taxable possessory interest, the value of the reversion is discounted to a present value, which is then subtracted from the as-if-in-fee value. Should a property tax component be added to the rate that is used to discount the reversion? The answer is no. Again, a property tax component should be added only if the property taxes will be paid out of the income to be capitalized as an operating expense, that is, in terms of Rule 8 as an element of "gross outgo." This is not the case when discounting the value of the reversion. The reversion of the rights possessed reflects the value of the property (those rights) at the end of the term of possession, when the right to possession will revert back to the public entity.

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[40] The rationale for adding a property tax component to the capitalization rate, rather than deducting an amount for property taxes from the income to be capitalized, is that the latter presumes that the appraiser knows beforehand the value he or she is attempting to estimate. That is, since property is assessed ad valorem, it would be necessary for the appraiser to know the value of the subject property in order to estimate the property taxes. This puts the cart before the horse.

Income Approach-Direct Method

In the income approach-direct method, the appraiser estimates the value of the subject taxable possessory interest by discounting either the estimated economic rent (less allowed expenses paid by the public owner) or that portion of the estimated future net operating income attributable to the subject taxable possessory interest for the reasonably anticipated term of possession using a discount rate that reflects the risk associated with the receipt of the expected future net operating income. The direct income method is probably the most widely used method in the valuation of taxable possessory interests because of the quantity and quality of data available relating to market (economic) rents.

As discussed in the previous section, the income to be capitalized may derive from either rents or operations (i.e., rental income or operating income) and should be estimated in accordance with subsection (c) of Rule 8. Also as discussed above, the capitalization (discount) rate should be developed in accordance with subsection (g) of Rule 8.

The following example illustrates the valuation of a taxable possessory interest using the income approach-direct method:

EXAMPLE 3.3

USING THE INCOME APPROACH-DIRECT METHOD TO VALUE TAXABLE POSSESSORY INTEREST

Subject taxable possessory interest: grazing rights on federal lands. For purposes of illustration calculations assume rent payment at the end of the period. Where rents are payable in advance calculations should reflect that fact.

PERTINENT INFORMATION:

- U.S. Forest Service grazing permit for 200 animal unit months (AUMs) per year. (An AUM represents the grazing of one animal for one month.)
- Reasonably anticipated term of possession: 10 years
- Contract rent: $2.00 per AUM
- Market (economic) rent: $10.00 per AUM. Derived from leases of comparable privately owned lands
- Allowable expenses: 5%
- Capitalization (discount) rate, exclusive of property taxes: 12%
  Added component for property taxes (general rate): 1%

In this approach, the appraiser capitalizes (discounts) the estimated market (economic) rent over the reasonably anticipated term of possession.

Although often the contract rent is a valid indicator of the market (economic) rent, the appraiser should not uncritically accept it as the market (economic) rent.

In this example, it was necessary to add a property tax component to the discount rate because the market rent for the subject taxable possessory interest is derived from rental data in which the landlord pays the property taxes.

Estimated annual market rent: (200 AUM @ $10/AUM)	$2,000
Less allowable expenses: 5%	$100
Net income:	$1,900
	x
Present value factor: (PV$1PP (annual)/10 yrs/13% = 5.43)	5.43
Indicated Value	$10,317

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EXAMPLE 3.4

USING THE INCOME APPROACH-DIRECT METHOD TO VALUE TAXABLE POSSESSORY INTEREST

Subject taxable possessory interest: carnival agreement at the county fair grounds. For purposes of illustration calculations assume rent payment at the end of the period. Where rents are payable in advance calculations should reflect that fact.

PERTINENT INFORMATION:

- Second year of a three year agreement with District Agricultural Association to provide the carnival at the county fair each year for one week.
- Reasonably anticipated term of possession: 2 years
- Market rent: flat rate payment of $68,000 versus 30% of gross sales. Annual estimate: $X
- Allowable expenses (paid by public owner and are necessary for the continued production of income to the possessory interest): management (Includes public owner's cost to write lease. Does not, however, include tenant's cost of writing or negotiating lease.), maintenance, insurance, utilities, trash removal, security, advertising and promotions, and attractions and entertainment: Total $Y
- Capitalization (discount) rate, exclusive of property taxes: R%
  Added component for property taxes (general rate): 0%

In this approach, the appraiser capitalizes (discounts) the estimated market (economic) rent over the reasonably anticipated term of possession.

Although often the contract rent is a valid indicator of the economic rent, the appraiser should not uncritically accept it as the economic rent.

Event specific expenses should be prorated among all the tenants at the event. Allowable expenses not directly related to a specific event (e.g., annual general and ongoing) should be allocated among all tenants present during the year.

In this example, it was not necessary to add a property tax component to the discount rate because the property taxes are not a part of the income to be capitalized.

Forecast potential gross income:	$X
Less allowable expenses:	$Y
Net income:	$Z
	x
Present value factor: (PV$1PP (annual)/2 yrs/R% = U):	U
Indicated Value:	$V

Income Approach-Indirect Method

The income approach-indirect method is very similar in concept to the comparative sales approach-indirect method. The only difference is that with the income approach-indirect method, the appraiser estimates the as-if-in-fee value of the taxable possessory interest using the "conventional" income approach rather than the "conventional" comparative sales approach. Thus, the income approach-indirect method involves the following two steps:

1. The appraiser estimates the value of the subject taxable possessory interest as if it were owned in fee simple, using a "conventional" income approach to estimate the as-if-in-fee value of the subject taxable possessory interest. Direct capitalization, yield capitalization, or both may be used to estimate the as-if-in-fee value.

2. The appraiser subtracts the estimated present value of the nontaxable reversionary interest for the rights possessed retained by the public owner from the as-if-in-fee value estimated in No. 1 above. The estimated present value of the reversion can be estimated using the methods described in the discussion of the comparative sales approach-indirect method.

The following example illustrates the valuation of a taxable possessory interest using the income approach-indirect method:

EXAMPLE 3.5

USING THE INCOME APPROACH-INDIRECT METHOD TO VALUE TAXABLE POSSESSORY INTEREST

Subject taxable possessory interest: the right to possess a mini-storage warehouse, newly constructed by possessor, located within a CalTrans right-of-way.

PERTINENT INFORMATION:

- Estimated value of taxable possessory interest as-if-owned-in-fee simple: $1,125,000.
- The appraiser would estimate this value using direct or yield capitalization.
- The appraisal unit comprises land and improvements (assuming an improved property).
- Reasonably anticipated term of possession: 30 years.
- Based on the stated term of possession (i.e., remaining term of the lease on the valuation date, including options).
- Estimated value of the reversion: $2,730,668.
- Estimated real property value 30 years hence, given the 30-year reasonably anticipated term of possession. The appraiser estimates that the value of the subject property [land and improvements] will appreciate at a compound rate of 3 percent per year for the reasonably anticipated term of possession. ($1,125,000 x 2.42726 [FV$1/30 yrs/3%] = $2,730,668.)
- Capitalization, or discount, rate used to discount the reversionary value, exclusive of property taxes: 12%.
- Developed using any of the methods described above. It is not necessary to add a property tax component to the discount rate when discounting the reversionary value.

As noted, the income approach-indirect method is identical in concept to the comparative sales approach-indirect method, except that the appraiser estimates the as-if-in-fee simple value using the income approach rather than the comparative sales approach.

As-if-in-fee value of subject taxable possessory interest:	$1,125,000	
Less: present value of reversion:		
= $2,730,668 x PV$1/30 yrs/12%		
= $2,730,668 x 0.033378 =	(91,444)	
Value indicator:	$1,033,556	say, $1,033,500

Cost Approach (Post-*De Luz*)

In the cost approach, as applied to taxable possessory interests, the estimated value of the subject taxable possessory interest in land is added to the estimated value of the subject improvements, and this sum is reduced by the estimated present value, if any, of the subject improvements upon reversion to the public owner. The cost approach is often used when improvements are constructed by the possessor.

The cost approach thus involves the following steps:

1. Estimate the value of the subject improvements based on their estimated cost new less the depreciation. Typically, depreciation is estimated using a standard depreciation schedule.

2. Estimate the value of the taxable possessory interest in land. This value may be estimated using one or more of the previously discussed methods—that is, the comparative sales approach (direct or indirect method) or the income approach (direct or indirect method).

3. Add the estimated value of the subject improvements to the estimated value of the taxable possessory interest in land. As in the "conventional" cost approach, land and improvements are valued separately and summed.

4. Finally, subtract the estimated present value, if any, of the nontaxable reversionary improvements from the amount in No. 3 above. If the estimated remaining economic life of the subject improvements exceeds the reasonably anticipated term of possession, there will be a reversionary improvement value. As in No. 1 above, typically, the reversionary value of the improvements is estimated based on their estimated cost new less depreciation at the end of the reasonably anticipated term of possession.

The estimated value of the improvements must be consistent with the permitted use under the taxable possessory interest. If the permitted use does not correspond to the use for which the subject improvements were originally designed and constructed, the cost new less depreciation of the subject improvements may not be a reliable indicator of the value of the taxable possessory interest in the improvements.

If the possessor's use of the property is limited to specified time periods or is shared with other possessors, the final value indicator from the cost approach must be allocated to the subject taxable possessory interest in a manner that reflects the proportionate value of the subject taxable possessory interest.

The difficulty with the cost approach is that it includes all interests in the improvements and may require adjustments for restrictions imposed in the lease agreement. In some leases there may be many restrictions that have to be separately valued and deducted when using the cost approach.

The following example illustrates the valuation of a taxable possessory interest using the cost approach:

EXAMPLE 3.6

USING THE COST APPROACH TO VALUE TAXABLE POSSESSORY INTEREST

Subject taxable possessory interest: the right to possess a maintenance building constructed by the possessor at a publicly owned airport. For purposes of illustration calculations assume rent payment at the end of the period. Where rents are payable in advance calculations should reflect that fact.

PERTINENT INFORMATION:

- The possessor groundleases 1.50 acres of land (65,340 square feet) from the airport authority and constructs a 45,000 square foot aircraft maintenance building. The market ground rent is $0.10 per square foot per month, or $78,408 per year. The market rent is constant over the reasonably anticipated term of possession.
- Allowable expenses: Management and administration – 5%, and road and access repairs - $1,000.
- The reasonably anticipated term of possession is 30 years, based on the stated term of possession (the remaining term of the ground lease on the valuation date). There are no factors that indicate that the reasonably anticipated term of possession is other than 30 years.
- The capitalization (discount) rate is 12%. The capitalization rate could be developed by any of the described methods. In the example, it is not necessary to add a property tax component to the discount rate because the possessor will pay the possessory interest taxes in addition to the ground rent.

A. Computation of possessory interest value in land:

The appraiser estimates the value of the taxable possessory interest in land using the income approach-direct method, that is, by discounting the estimated market rent over the reasonably anticipated term of possession ($78,408 - $3,920 - $1,000 = $73,488 x 8.055 [PV$1PP, 30 yrs/12%] = $591,946, rounded to $592,000). The appraiser could estimate the value of the taxable possessory interest in land using this method or any of three other methods—the comparative sales approach-direct method, the comparative sales approach-indirect method, or the income approach-indirect method—with the selected method(s) determined by the quantity and quality of the data.

The estimated market value of the taxable possessory interest in land is $592,000.

EXAMPLE 3.6 (CONTD.)

B. Computation of possessory interest value in improvements:

Typically, the appraiser will estimate the value of the improvement using the possessor's reported costs, an independent cost estimate based on cost service data, or both. The objective is an estimate of the replacement cost new less depreciation of the improvements that includes all components of full economic cost. Next, the appraiser must decide whether to attribute a reversionary value to the improvements. In the example, we assumed that the improvement value at the end of the reasonably anticipated term of possession is $1,213,630*; thus, it is necessary to adjust the improvement value for a reversionary value ($1,213,630 x .033378 [PV$1/30 yrs/12%] = $40,508 rounded to $40,500).

*Estimated improvement value 30 years hence, given the 30-year reasonably anticipated term of possession. The appraiser estimates that the value of the subject improvements will appreciate at a compound rate of 3 percent per year for the reasonably anticipated term of possession. ($1,000,000 x 2.42726 [FV$1/30 yrs/3%] = $2,427,260 x 50 percent good = $1,213,630.)

On subsequent valuation dates, the appraiser also would estimate the value of the improvements based on replacement cost new less depreciation, probably by adopting a standard depreciation schedule, for example, straight-line depreciation.

The estimated market value of the taxable possessory interest in improvements is $1,000,000.

Estimated market value of the taxable possessory interest in land:	$591,946	say	$592,000
Estimated market value of the taxable possessory interest in improvements:			$1,000,000
Estimated present value of the nontaxable reversionary improvements:			($40,500)
Estimated market value of the entire subject taxable possessory interest:			$1,551,500

Summary: Post-*De Luz* Taxable Possessory Interest Valuation Methods

Comparative Sales Approach-Direct Method

	Equity sale price (subject or comparable)
Adjust for (+ or -)	Cash equivalence
Adjust for (+ or -)	Market conditions
Adjust for (+ or -)	Comparability
Add	Present value of the contract rent (less any allowed expenses paid from the contract rent by the public owner) for the reasonably anticipated term of possession.
Add	Present value of possessor's contractually obligated future costs, if any.
Subtract	Present value of possessor's contractually entitled benefits, if any.
Equals	Indicated value of subject taxable possessory interest

Comparative Sales Approach-Indirect Method

Estimate	Value of the subject taxable possessory interest as if owned in fee (i.e., owned in perpetuity) using the "conventional" comparative sales approach.
Estimate	Reversionary value of the subject taxable possessory interest
Calculate	Present value of the reversion.
Subtract	Present value of the reversion from the estimated fee value.
Equals	Indicated value of subject taxable possessory interest.

Income Approach-Direct Method

Estimate	Expected market (economic) rent of the rights of possession under the subject taxable possessory interest over the reasonably anticipated term of possession.
Calculate	Present value of the future expected market rents.
Equals	Indicated value of subject taxable possessory interest.

Income Approach-Indirect Method

Estimate	Value of the subject taxable possessory interest as if fee owned (i.e., owned in perpetuity) using the "conventional" income approach.
Estimate	Reversionary value of the subject taxable possessory interest.
Calculate	Present value of the reversion.
Subtract	Present value of the reversion from the estimated fee value.
Equals	Indicated value of subject taxable possessory interest.

Cost Approach

Estimate	Value of the improvements on the valuation date (estimated replacement cost new less depreciation).
Estimate	Value of the taxable interest possessory in land, using the comparative sales approach (direct or indirect method) or the income approach (direct or indirect method).
Sum	Estimated value of the improvements and estimated value of the taxable possessory interest in land.
Subtract	Present value of the estimated future reversionary value of the improvements, if any.
Equals	Indicated value of subject taxable possessory interest.

VALUATION OF PRE-*DE LUZ* TAXABLE POSSESSORY INTERESTS

As discussed above, pre-*De Luz* taxable possessory interests are interests that were created prior to the effective date (i.e., December 25, 1955) of *De Luz Homes, Inc. v. County of San Diego* and that have not since been extended or renewed. Under section 107.1, the full cash value of such interests is limited to the possessor's equity value in the leasehold interest. A taxable possessory interest valued under a pre-*De Luz* method will always have a lower value than if it were valued under a post-*De Luz* method.

The clearest way to present the valuation methods for pre-*De Luz* taxable possessory interests is to simply describe how each pre-*De Luz* method differs from the corresponding post-*De Luz* method described earlier. As with post-*De Luz* taxable possessory interests, there are five methods of valuation for pre-*De Luz* taxable possessory interests:

1. Comparative Sales Approach (Pre-*De Luz*)
    - Comparative Sales Approach-Direct Method
    - Comparative Sales Approach-Indirect Method
2. Income Approach (Pre-*De Luz*)
    - Income Approach-Direct Method
    - Income Approach-Indirect Method
3. Cost Approach (Pre-*De Luz*)

Each pre-*De Luz* valuation method requires a single adjustment only to the corresponding post-*De Luz* method to arrive at the pre-*De Luz* value indicator.

Comparative Sales Approach (Pre-*De Luz*)

Comparative Sales Approach-Direct Method

The subject taxable possessory interest is valued as in the corresponding post-*De Luz* method described earlier, but the present value of the unpaid future contract rent for the reasonably anticipated term of possession is not added to the sale price of the taxable possessory interest.

Comparative Sales Approach-Indirect Method

The subject taxable possessory interest is valued as in the corresponding post-*De Luz* method described earlier, but the value of the private possessor's rights as if owned in fee (i.e., as if owned in perpetuity) is reduced by the present value of the unpaid future contract rent for the reasonably anticipated term of possession in addition to being reduced by the present value of the reversionary rights of the public owner.

Income Approach (Pre-*De Luz*)

Income Approach-Direct Method

The subject taxable possessory interest is valued as in the corresponding post-*De Luz* method described earlier, but the net income to be capitalized is reduced by the unpaid future contract rent for the reasonably anticipated term of possession in addition to the reductions for allowed expenses.

Income Approach-Indirect Method

The subject taxable possessory interest is valued as in the corresponding post-*De Luz* method described earlier, but the value of the possessor's rights as if owned in fee (i.e., as if owned in perpetuity) is reduced by the present value of the unpaid future contract rent for the reasonably anticipated term of possession in addition to being reduced by the present value of the reversionary rights of the public owner.

Cost Approach (Pre-*De Luz*)

The subject taxable possessory interest is valued as in the corresponding post-*De Luz* method described earlier, but the indicated value is reduced by the present value of the unpaid contract rent for the taxable possessory interest in land for the reasonably anticipated term of possession.

Summary—Pre-*De Luz* Valuation Methods

PRE-*DE LUZ* VALUATION METHOD	**DIFFERENCE FROM POST-*DE LUZ* METHOD**
Comparative Sales Approach-Direct Method	Do not add the present value of unpaid future contract rent to the sale price of the taxable possessory interest.
Comparative Sales-Indirect Method	Subtract the present value of unpaid future contract rent from as-if-in-fee value of the taxable possessory interest.
Income-Direct Method	Reduce the net income to be capitalized by the unpaid contract rent of the taxable possessory interest.
Income-Indirect Method	Subtract the present value of the unpaid future contract rent from as-if-in-fee value of the taxable possessory interest.
Cost Approach	Reduce the indicated value by the present value of the unpaid contract rent for the taxable possessory interest in land.

APPLICABILITY OF VALUATION METHODS

Read together, Rules 4, 6, and 8 provide an order of preference for the applicability of the valuation approaches. When reliable comparative sales data are available, the preferred valuation approach is the comparative sales approach. When market sales data are not available, but an income for the subject property can be reliably estimated, the income approach is the next preferred approach. Finally, when neither reliable sales nor income data are available, the cost approach is preferred. The same order of preference applies to the valuation approaches for taxable possessory interests.

In practice, as most appraisers realize, the application of the valuation approaches is strongly influenced by the quantity and quality of the available data. Set forth below are some comments regarding the applicability of the taxable possessory interest valuation approaches:

1. For most types of taxable possessory interest, sales data are very scarce. This limits the application of the comparative sales approach-direct method, which relies on sales data. Nevertheless, this approach is sometimes applied to those types of interests for which sales data may be available (e.g., resort cabins and boat slips).

2. Because quality rental data is often readily available, the income approach-direct method is probably the most widely used valuation method for taxable possessory interests. This is particularly true for taxable possessory interests in land only, but it is also true for taxable possessory interests that include improvements (in which case, of course, the income to be

capitalized would include the income attributable to the entire appraisal unit, that is, both land and improvements).

3. The comparative sales approach-indirect method requires an estimate of the reversionary value of the appraisal unit (i.e., either land only or land and improvements if the subject taxable possessory interest is improved). An estimate of this value may be speculative because it requires the appraiser to estimate the value of the subject property as of a future date. This shortcoming, however, is mitigated if the reasonably anticipated term of possession is either relatively long or relatively short. If the reversion is far into the future, the estimate of the reversionary value is less significant because it will be deeply discounted and will have a relatively insignificant impact on the value indicator. If the reversion is near into the future, an estimate of its value is significantly less speculative.

4. As with the comparative sales approach-indirect method, the limitation of the income approach-indirect method involves the difficulty of supporting a reversionary value tied to a future date. But again this drawback is reduced if the reversion occurs either relatively far or relatively near into the future.

5. The cost approach is almost always used when the improvements are constructed by the possessor, although it also may be applicable in other circumstances. As with the conventional cost approach used in the valuation of a fee simple interest, the difficult aspect of the approach with taxable possessory interests also involves an estimate of the amount of depreciation. With a taxable possessory interest, applying the cost approach also requires a determination of the reversionary value, if any, of the improvements and a technique for estimating this value. The value of the associated taxable possessory interest in land, as discussed, can be estimated using any of the other four valuation methods for taxable possessory interests, subject to the attendant limitations.

CHAPTER 4: TAXABLE POSSESSORY INTERESTS AND ARTICLE XIII A OF THE CALIFORNIA CONSTITUTION

This chapter discusses taxable possessory interest assessment in the context of article XIII A of the California Constitution (i.e., "Proposition 13," the tax limitation initiative approved in June 1978). In general, the provisions of article XIII A and related statutes and regulations apply to the assessment of taxable possessory interests. In brief, this means the following:

- A taxable possessory interest receives a base year value according to section 110.1.
- Annually thereafter, the taxable value of the possessory interest is the lesser of its factored base year value or its fair market value, as prescribed in section 51.
- A taxable possessory interest is subject to the change in ownership and new construction provisions of sections 60 and following and sections 70 and following, respectively.
- A taxable possessory interest, with one excepted case, is subject to supplemental assessment under sections 75.10 and following.

In addition to the above, at the end of the chapter we discuss some general assessment issues related to taxable possessory interests that do not derive from article XIII A.

BASE YEAR VALUE

As with other real property and as provided in section 110.1, a taxable possessory interest in existence on March 1, 1975, received a base year value equal to its fair market value as of that date, with that value indexed by the inflation factor to the 1978 lien date. A taxable possessory interest created after March 1, 1975, receives a base year value equal to its fair market value on the date of its change in ownership.[41] The base year value for taxable improvements on tax-exempt land completed after March 1, 1975, is based on the fair market value of the newly constructed improvements on their date of completion.

TAXABLE VALUE ON EACH LIEN DATE

As with other real property, and as provided in section 51, the taxable value of a taxable possessory interest on each lien date is the lesser of (1) its base year value compounded annually since its base year by the annual inflation factor or (2) its fair market value ("full cash value") on the lien date taking into account factors that may have caused a decline in value of the taxable possessory interest. Taxable possessory interests may also qualify for valuation under the disaster, misfortune, or calamity provisions of subdivisions (b) and (c) of section 51.

[41] The change in ownership date of a taxable possessory interest may be based on the interest's date of creation, renewal, extension, or assignment, depending on the circumstances; change in ownership is discussed in more detail below.

Among the factors that may cause a decline in value of a taxable possessory interest is a reduction in the reasonably anticipated term of possession used to value the interest. As discussed in Chapter 3, if the reasonably anticipated term of possession is based on the stated term of possession, the term of possession will decline each lien date. Other market factors, however, may counteract the effect of a declining term of possession such that the market value of the taxable possessory interest does not decline.

CHANGE IN OWNERSHIP

Under Article XIII A of the California Constitution and related legal provisions, real property is reappraised on a change in ownership. The general definition of change in ownership appears in section 60:

> A "change in ownership" means a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

Thus, under the above definition, in order to constitute a change in ownership, a transfer must meet three tests: (1) it must convey a present interest in the real property; (2) it must convey beneficial use of the real property; and (3) it must convey an interest in the real property that is substantially equal in value to the fee simple interest. Change in ownership provisions specifically applicable to taxable possessory interests are discussed below.

REVIEW OF LEGAL PROVISIONS

The legal provisions that relate to a change in ownership of a taxable possessory interest are contained in sections 61 and 62 and Rule 462.080. Under subdivision (d) section 61, the following events constitute a change in ownership of a taxable possessory interest:

- The creation, renewal, extension, or assignment of a taxable possessory interest for any term, with the following exception: The renewal or extension of a taxable possessory interest during the reasonably anticipated term of possession used by the assessor to establish the existing base year value of the interest does not constitute a change in ownership until the end of that reasonably anticipated term of possession. (Section 61, subdivision (b)(2); Rule 462.080, subsection (b)(2).) Creation, renewal or extension, and assignment are defined as follows:

    "Creation" of a taxable possessory interest includes (i) an initial grant or other conveyance of a taxable possessory interest; (ii) a subsequent grant or other conveyance of additional land or improvements to an existing taxable possessory interest; or (iii) a subsequent grant or other conveyance of additional valuable property rights to uses to a preexisting taxable possessory interest. (Rule 21, subsection (a)(9).)

    "Renewal" or "extension" of a taxable possessory interest means the lengthening of the period of possession of a taxable possessory interest, such as by the exercise of an option to renew or to extend a lease or permit. But "renewal" and "extension" do not include the granting of an option to renew or extend an existing agreement pursuant to which the term of possession of the existing agreement would, upon exercise of the option, be lengthened, whether the option is granted in the original agreement or subsequently. (Rule 21, subsection (a)(10); Rule 462, subsection (a).)

"Assignment" of a taxable possessory interest means the transfer of all rights held by a transferor in a taxable possessory interest. (Section 61, subdivision (b)(3).)

- The sublease of a taxable possessory interest for a term (including renewal options) that exceeds half the length of the remaining term of the master taxable possessory interest (including renewable options). (Section 61, subdivision (d)(1).)
- The termination of a sublease of a taxable possessory interest with an original term (including renewal options) that exceeds half the length of the remaining term of the master taxable possessory interest (including renewal options) when the sublease was entered into. (Section 61, subdivision (d)(1).)
- The transfer of a sublessee's interest with a remaining term (including renewal options) that exceeds half of the remaining term of the master taxable possessory interest (including renewal options). (Section 61, subdivision (d)(1).)
- The transfer of a taxable possessory interest subject to a sublease with a remaining term (including renewal options) that does not exceed half the remaining term of the master taxable possessory interest (including renewal options). (Section 61, subdivision (d)(2).)

Under section 62 and Rule 462.080, the following activities do not constitute a change in ownership of a taxable possessory interest:

- The creation of an interest by reservation in the instrument that deeds the interest to a tax exempt government entity, regardless of whether the interest created is an estate for years or an estate for life. (Rule 462.080, subsection (b)(1).)
- The sublease of a taxable possessory interest for a term (including renewal options) that does not exceed half the length of the remaining term of the master taxable possessory interest (including renewal options). (Rule 462.080, subsection (b)(3).)
- The termination of a sublease of a taxable possessory interest having an original term (including renewal options) that did not exceed half the length of the remaining term of the master taxable possessory interest (including renewal options) when the sublease was entered into. (Rule 462.080, subsection (b)(4).)
- The transfer of a sublessee's interest in a taxable possessory interest, with a remaining term (including renewal options) that does not exceed half of the remaining term of the master taxable possessory interest. (Rule 462.080, subsection (b)(5).)
- The transfer of a taxable possessory interest subject to a sublease with a remaining term (including renewal options) that exceeds half the length of the remaining term of the master

taxable possessory interest (including renewal options). (Rule 462.080, subsection (b)(6); section 62, subdivision (o).)

Summary: Taxable Possessory Interests and Change in Ownership Provisions

CONSTITUTES A CHANGE IN OWNERSHIP	EXCLUDED FROM A CHANGE IN OWNERSHIP
The creation, renewal, extension, or assignment of a taxable possessory interest for any term, with the following exception. A renewal or extension does not constitute a change in ownership until the end of the reasonably anticipated term of possession used by the assessor to establish the existing base year value of the interest. [Section 61, subdivision (b)(1).]	
	The creation of an interest by reservation in an instrument that deeds the interest to a tax exempt government entity, regardless of whether the interest created is an estate for years or an estate for life. [Rule 462.080, subsection (b)(1).]
The sublease of a taxable possessory interest for a contract term (including any renewal options) that exceeds half the length of the remaining contract term (including any renewal options) of the master taxable possessory interest. [Section 61, subdivision (d)(1).]	The sublease of a taxable possessory interest for a term (including renewal options) that does not exceed half the length of the remaining contract term of the master taxable possessory interest (including renewal options). [Rule 462.080, subsection (b)(3).]
The termination of a sublease of a taxable possessory interest with an original contract term (including any renewal options) that exceeds half the length of the remaining contract term (including any renewal options) of the master taxable possessory interest when the sublease was entered into. [Section 61, subdivision (d)(1).]	The termination of a sublease of a taxable possessory interest with an original term (including renewal options) that did not exceed half the length of the remaining contract term of the master taxable possessory interest (including renewal options) when the sublease was entered into. [Rule 462.080, subsection (b)(4).]
The transfer of a sublessee's interest in a taxable possessory interest with a remaining contract term (including any renewal options) that exceeds half the remaining contract term of the master taxable possessory interest. [Section 61, subdivision (d)(1).]	The transfer of a sublessee's interest in a taxable possessory interest, with a remaining term (including any renewal options) that does not exceed half of the remaining contract term of the master taxable possessory interest. [Rule 462.080, subsection (b)(5).]
The transfer of a taxable possessory interest subject to a sublease with a remaining contract term (including any renewal options) that does not exceed half the contract term of the master taxable possessory interest. [Rule 61, subdivision (d)(2).]	The transfer of a taxable possessory interest subject to a sublease with a remaining contract term (including any renewal options) that exceeds half the length of the remaining contract term of the master taxable possessory interest (including any renewal options). [Rule 462.080, subsection (b)(6); section 62, subdivision (o)]

SUBLEASES AND CHANGE IN OWNERSHIP

Most of the above provisions pertain to the change in ownership implications of a sublease of a taxable possessory interest. The sublease provisions regarding taxable possessory interests are analogous to those contained elsewhere in statute that pertain to change in ownership vis-à-vis leasehold interests in privately owned real property. The guiding principle behind them is that a change in ownership occurs, for property tax purposes, when the primary economic interest in a property transfers. In the case of privately owned property held in fee simple, this is deemed to occur with the creation of a leasehold interest of 35 years or more. In the case of a taxable possessory interest, this is deemed to occur with the creation of subleasehold interest in the taxable possessory interest that is greater than half the remaining term of the taxable possessory interest itself.

Thus, for example, as to privately owned real property held in fee, a change in ownership occurs when a lease of 35 years or more is created, but a change in ownership does not occur when there is a transfer of an underlying fee interest that is subject to a leasehold interest of 35 years or more. In the first case, the primary economic interest in the property transfers; in the second, it does not. Similarly, a change in ownership occurs when a sublease of a taxable possessory interest is created that has a contract term that is greater than half the remaining term of the taxable possessory interest, but a change in ownership does not occur when there is a transfer of the taxable possessory interest subject to a subleasehold interest with a contract term greater than half the remaining term of the taxable possessory interest.

When a change in ownership of a taxable possessory interest occurs because of a sublease transaction, and the sublease involves a portion rather than all of the taxable possessory interest, only the subleased portion of the taxable possessory interest changes ownership, not the entire taxable possessory interest; that is, only a portion of the existing taxable possessory interest should receive a new base year value. In this case, establishing the new assessed value of the subject taxable possessory interest involves removing the portion of its base year value that corresponds to the newly subleased portion and adding the value of the newly subleased portion that results from the change in ownership.

When estimating the value of a subleased portion, the valuation variables, whatever the approach used, should reflect market conditions on the valuation date (i.e., the date of the change in ownership). The correct term of possession is the reasonably anticipated term of possession of the "parent" taxable possessory interest (i.e., the master taxable possessory interest or masterleasehold interest) because it is this property interest (or a portion thereof) that changed ownership and, consequently, is being revalued.

EXAMPLE 4.1

SUBLEASE OF TAXABLE POSSESSORY INTEREST AND CHANGE IN OWNERSHIP

Assume a private developer leases a 50-acre tract of land from a public entity for 60 years. The assessor values the taxable possessory interest based on the stated term of possession—that is, the remaining term under the lease—which initially is 60 years.

Five years later, the developer subleases 10 acres of the tract to a private corporation for 30 years. The sublease constitutes a change in ownership of the 10-acre portion because the sublease is for a period greater than half the remaining term of the taxable possessory interest (i.e., 30 years > ½ of 55 years). The reasonably anticipated term of possession used in the valuation of the subleased portion should be 55 years, based on the master taxable possessory interest, not 30 years based on the remaining term of the sublease.

Which party should be assessed is largely in the assessor's discretion. Section 405 provides that the assessor shall assess all taxable property in the county, except state-assessed property, "to the persons owning, claiming, possessing, or controlling it on the lien date." The section does not limit the assessor to either the holder of the taxable possessory interest (i.e., the masterlessee) or the holder of the subleasehold interest (i.e., the sublessee). Instead, the statute authorizes an assessment to either party or both.[42]

CHANGE IN OWNERSHIP AND LEASED PROPERTY ACQUIRED BY A PUBLIC ENTITY

Two questions arise when a public entity acquires privately owned real property subject to a lease, that is, when the public entity acquires a leased fee interest:[43]

1. Do any leasehold interests that exist on the acquisition date become taxable possessory interests on that date?

2. If so, is there a change in ownership of such interests on the acquisition date?

The answer to the first question is that, assuming they satisfy the legal criteria for constituting a taxable possessory interest, the leasehold interests become separately assessable taxable possessory interests on the date of acquisition by the public entity. The answer to the second question, however, is that the acquisition does not constitute a change in ownership of the leasehold interests for the purposes of section 61(b). The tenant's leasehold interests have not changed ownership. Such interests should be valued as if they had been taxable possessory

[42] Although it does not specifically address the sublease of a taxable possessory interest, see also section 2188.4.

[43] A common example of this occurs when a public employees retirement system acquires investment real estate subject to existing leases.

interests when the leases commenced. In other words, they should receive a base year value, in retrospect, as of the date the leases commenced. If the interests are subsequently renewed, extended, or assigned, of course, a change in ownership under section 61(b) occurs, and they should be reassessed and new base year values established.[44]

MONTH-TO-MONTH TENANCIES AND CHANGE IN OWNERSHIP

When a tenant "carries over" under a month-to-month tenancy, this is a change in ownership.

Civil Code section 1946 states:

> A hiring of real property, for a term not specified by the parties, is deemed to be renewed as stated in Section 1945, at the end of the term implied by law unless one of the parties gives written notice to the other of his intention to terminate the same.…

And under Civil Code section 1945:

> If a lessee of real property remains in possession thereof after the expiration of the hiring, and the lessor accepts rent from him, the parties are presumed to have renewed the hiring on the same terms and for the same time, not exceeding one month when the rent is payable monthly, nor in any case one year.

Thus, pursuant to the above, a taxable possessory interest consisting of a month-to-month tenancy is renewed each month that a notice to terminate is not given, and a "renewal" constitutes a change in ownership under subdivision (b) of section 61. But, as discussed, under subdivision (b)(2) of section 61, the change in ownership would not be recognized until the end of the reasonably anticipated term of possession used by the assessor to establish the existing base year value of the interest.

NEW CONSTRUCTION

The statutory and regulatory provisions governing the assessment of "newly constructed" real property, or "new construction," are contained in section 70 et seq. and Property Tax Rules 463 and 463.500, respectively. Briefly described, these provisions explain the application of the base-year-value concept to newly constructed real property, define what constitutes new construction, cite specific statutory exclusions from new construction, and define the "date of completion" of new construction. As with all other newly constructed real property assessed under article XIII A, the assessment of new construction associated with a taxable possessory interest is governed by these provisions. By "new construction associated with a taxable possessory interest," we mean new construction that is directly related to the exercise of the rights held under the subject taxable possessory interest.

[44] Letter To Assessors 83/03 should be disregarded to the extent that it conflicts with this advice.

In Chapter 2 we pointed out that all improvements associated with a taxable possessory interest, whether constructed or owned by the private possessor or the public owner, are part of the taxable possessory interest. Because they are part of the taxable possessory interest, all improvements should be valued as a taxable possessory interest—that is, net of the estimated present value of their reversionary value, if any.

New construction often is valued using the cost approach. In the case of new construction associated with a taxable possessory interest, if the appraiser uses the cost approach to derive a value indicator, the appraiser should adjust the cost indicator to account for the reversionary value, if any. This adjustment may be significant or nil, depending on the specific circumstances.

SUPPLEMENTAL ASSESSMENT

The legal provisions governing supplemental assessment are found in section 75 et seq. In general, a taxable possessory interest is subject to supplemental assessment in the same manner as other real property subject to article XIII A of the California Constitution—that is, a taxable possessory interest is subject to supplemental assessment on change in ownership or new construction. A few issues regarding supplemental assessment, however, that are particular to taxable possessory interests are discussed below.

Section 75.5 exclusion. Under section 75.5, a newly created taxable possessory interest that is established by a month-to-month agreement and has a full cash value of $50,000 or less is excluded from supplemental assessment.

Termination and creation of interest in same tax year. This issue concerns what to do when one taxable possessory interest is terminated during an assessment year (i.e., after the January 1 lien date) and a second (but distinct) taxable possessory interest is created involving the same land and improvements during the same assessment year. Concerning this situation, some have raised the following questions:

1. Should there be a negative supplemental assessment (a "supplemental refund") for the taxable possessory interest that terminated?

2. Is the proper supplemental assessment amount for the newly created taxable possessory interest the fair market value of the newly created interest with no offset for an existing value on the regular assessment roll, or is it the fair market value of the newly created interest reduced by the existing roll value of the taxable possessory interest that terminated?

The proper treatment of this situation was described in Letter to Assessors No. 86/12, and that guidance remains in effect. There should not be a negative supplemental assessment for the taxable possessory interest that terminated, and the supplemental assessment amount for the newly created possessory interest should be based on its fair market value (i.e., its full cash value, or new base year value) without offset for a prior value on the regular assessment roll.

The reasoning behind this treatment is as follows. It is not the government's land and improvements that are being assessed; rather, it is the taxpayer's right to possess the land and improvements that is being assessed. Thus, each respective taxpayer's taxable possessory interest, each right to possess, is subject to separate assessment.[45]

To assess two successive (but distinct) taxable possessory interests involving the same real property does not constitute double taxation for the reason that double taxation only occurs when "two taxes of the same character are imposed on the same property by the same taxing authority within the same jurisdiction during the same time period."[46] In the case of two different (albeit successive) taxable possessory interests, the "same property" is not being taxed; thus, there is no double taxation.

If, however, an existing taxable possessory interest is assigned or otherwise transferred to another, it would violate the prohibition on double taxation to levy assessments on both the existing interest and the assigned interest. This treatment would impose two property taxes on the same taxable possessory interest for the same taxing period.

RECURRING TAXABLE POSSESSORY INTERESTS

A taxable possessory interest may recur from year to year without the possession, right to possession, or claim to a right to the possession inherent in the interest being continuous in time. That is, the possession, right to possession, or claim to a right to possession may apply to a recurring annual time period that is less than the entire year.

Under *Dressler v. County of Alpine*, a history of annually recurring taxable possessory interests with contract terms of less than one year ending on or before December 31 of each year may, under appropriate facts, establish the existence of an actual or constructive possession, right to possession, or claim to a right to possession that extends to each January 1 lien date.[47] Pursuant to this authority, under appropriate facts, assessors may make annual lien date assessments of such recurring taxable possessory interests.

[45] See *United States v. Fresno County* (1975) 50 Cal.App.3d 633; 640; Revenue and Taxation Code section 104, subdivision (a).
[46] See *Russ Building Partnership v. City and County of San Francisco* (1988) 199 Cal.App.3d 1496, 1509.
[47] *Dressler v. County of Alpine* (1976) 64 Cal.App.3d 557.

EXAMPLE 4.2

TERMINATION AND CREATION OF SEPARATE TAXABLE POSSESSORY INTEREST IN THE SAME ASSESSMENT YEAR INVOLVING THE SAME LAND AND IMPROVEMENTS

Assume that Taxpayer A holds a taxable possessory interest in a parking lot on January 1, 2001. The possessory interest is assessed at $100,000 for that lien date. On July 31, 2001, the lease expires, and Taxpayer A's taxable possessory interest is terminated. On September 1, 2001, Taxpayer B acquires a possessory interest in the same parking lot. This taxable possessory interest is assessed at $120,000, reflecting its fair market value on September 1.

The correct treatment is as follows: Taxpayer A does not receive a negative supplemental assessment; he is assessed based on $100,000 for the entire 2001-2002 fiscal year. Taxpayer B receives a supplemental assessment for the remainder of the 2001-2002 fiscal year based on a new base year value of $120,000. The amount of the supplemental assessment is $120,000; there is no offset for a current roll value in the levy of the supplemental assessment because two distinct interests—A's and B's—are being assessed.

If the example is modified slightly, however, a different conclusion results. If Taxpayer A had assigned or otherwise transferred the taxable possessory interest to Taxpayer B, the amount of Taxpayer B's supplemental assessment would have been $20,000 ($120,000 - $100,000); that is, the existing roll value of $100,000 would have been subtracted from the new base year value of $120,000. This treatment is based on the reasoning that the same interest is being taxed but to a new owner, Taxpayer B.

LOW-VALUE EXEMPTION

Under the provisions of section 155.20, a county board of supervisors may exempt from taxation, by local ordinance or resolution, all real property with a base year value so low that the total taxes, special assessments, and applicable subventions on the property are less than the cost of assessing and collecting them. In no instance, however, may a county exempt property with a base year value less than or equal to a statutory base year value limit; for most types of property, this limit is $5,000.

However, the statutory base year value limit is raised to $50,000 in the case of a taxable possessory interest for temporary or transitory use located in a publicly owned fairground, fairground facility, convention facility, or cultural facility. A "publicly owned convention or cultural facility" is defined in subdivision (b)(1) of section 155.20 as a publicly owned convention center, civic auditorium, theater, assembly hall, museum, or other civic building that is used primarily for staging conventions, trade and consumer shows, or civic and community events; live theater, dance, or musical productions; or artistic, historic, technological, or educational exhibits.

DISASTER RELIEF

Section 170 contains provisions related to the reassessment of property damaged by misfortune or calamity. The statute describes the conditions under which property is eligible for such reassessment, the method by which the damaged property should be reassessed, and the assessment roll procedures that should be used to effect the reassessment.

In general, under section 170, taxable possessory interests should be treated in the same manner as all other property. There is, however, one exception. Subdivision (a)(3) of section 170 applies specifically to taxable possessory interests. This subdivision provides that, with respect to a taxable possessory interest in land owned by the state or federal government, a misfortune or calamity that causes the possessor's right to possession to be suspended or restricted is eligible for reassessment. This subdivision cites a drought condition that affects state or federal lands in private possession as one example of such misfortune or calamity.

CHAPTER 5: SPECIAL ASPECTS OF TAXABLE POSSESSORY INTEREST ASSESSMENT

DISCOVERY OF TAXABLE POSSESSORY INTERESTS

Taxable possessory interests are often difficult for the assessor to discover. The document evidencing an interest (such as a lease or permit) may or may not be recorded. In addition, because taxable possessory interests involve publicly owned lands, interests may often go undiscovered by appraisers in the field.

There are several statutory provisions designed to help assessors discover the existence of taxable possessory interests (although none of them apply to federally owned real property). Of the statutory provisions, section 480.6 is the most notable and comprehensive.[48] This statute requires every state or local governmental entity that is the fee owner of real property in which a taxable possessory interest has been created to either (1) file the required preliminary change in ownership report or change in ownership statement with respect to a renewal of a taxable possessory interest; or (2) file an annual real property usage report that includes the following information:

- The name and address of the fee owner of the real property (i.e., the name of the public entity).
- The name and address of each holder of a taxable possessory interest in the real property.
- The type of transaction through which the holder of the taxable possessory interest acquired the interest (e.g., creation, renewal, sublease, or assignment).
- The description of the subject real property.
- The date of each transaction in which a holder of a taxable possessory interest in the real property acquired the interest.
- The terms of each transaction, to include the following: (i) the consideration given for the taxable possessory interest, whether in money or otherwise; (ii) the terms of the taxable possessory interest, including any options for renewal or extension; (iii) for any subleases, the original term and remaining term of the sublease, and the consideration paid for the master lease; and (iv) for any assignments, the original term and remaining term of the assignment and the consideration paid for the underlying lease.

[48] In addition to Revenue and Taxation Code section 480.6, Health and Safety Code section 33673.1 requires a redevelopment agency to provide notice to the assessor (within 30 days) when the agency leases real property in a redevelopment project to any legal entity for redevelopment. The notice must provide the date on which the private possessor/lessee acquired the beneficial use of the property and must be accompanied by a memorandum of lease and a map of the leased property. Also, under Streets and Highways Code section 104.10, the California Department of Transportation (CalTrans) must notify each county of the rental amount and location of each parcel of rental property administered by CalTrans for which rents are deposited in the State Highway Account of the State Transportation Fund.

The most reliable method of discovery for taxable possessory interests is for the assessor to contact those public entities—federal, state, and local—that own real property in which taxable possessory interests may have been created. Within each level of government, the assessor must also identify the specific agency or bureau that administers publicly owned lands.[49]

Although citing the requirements of section 480.6 may be helpful, relying on statutory reporting requirements alone usually is insufficient, and, in the case of taxable possessory interests in federally owned property, the reporting requirements are not applicable. Thus, rather than simply waiting for government entities to report the existence of taxable possessory interests, the assessor usually must take a more active approach. For example, the assessor might try the following:

1. First, the assessor could identify all possible government entities whose property might be subject to a taxable possessory interest within the county.

2. Second, for each such entity, the assessor could prepare a spreadsheet or table that describes all known taxable possessory interests related to the entity and the assessor's existing data relating to the interest (e.g., contract rent, remaining term, etc.).

3. Finally, each year the assessor could make a written request that asks each governmental entity to update the information on the assessor's spreadsheet regarding the taxable possessory interests to which the governmental entity is a party.

Essentially, this approach follows section 480.6, but the assessor takes the initiative. It also simplifies the task of the reporting government entity because the entity only has to report by exception, that is, the entity only has to indicate any changes to the prior year's report. Some assessors have implemented this or a similar approach through the electronic exchange of information with public agencies.

ASSESSMENT ENROLLMENT

Although, under California law, taxable possessory interests pertain only to interests in real property, property taxes on these interests generally are collected as if they were levied on unsecured personal property, with the assessor entering the assessed value of the taxable possessory interest on the unsecured roll. The tax levied against a taxable possessory interest becomes a lien against the taxable possessory interest; and under Sections 2901, 2903, and 2951, taxes on property on the unsecured roll are due immediately on assessment and may be collected by the assessor by seizure and sale of the property.

Under section 107, however, at the discretion of the county board of supervisors, any taxable possessory interest may be considered sufficient security for the payment of property taxes levied

[49] A list of federal, state, and local agencies that may lease public lands for private possession can be found in a report published by the State Lands Commission titled "Public Land Ownership in California." Mailing address: Public Land Ownership Report, State Lands Commission, 1020 12th Street, Second Floor, Sacramento, California 95814. Web site: <www.slc.ca.gov>.

on the interest and may be enrolled on the secured roll. In addition, under section 2190, the assessment of any taxable possessory interest to which a homeowners' exemption has been applied must be entered on the secured roll.

TAXABLE POSSESSORY INTERESTS AND PROPERTY TAXABLE UNDER SECTION 11 OF ARTICLE XIII OF THE CALIFORNIA CONSTITUTION

In general. Real property owned by a local government (such as a county, city, or special district) and located outside its boundaries is subject to taxation under the provisions of section 11 of article XIII of the California Constitution. In general, land owned by a local government and located outside its boundaries is taxable if the land was taxable when acquired, and improvements owned by a local government and located outside its boundaries are taxable if the improvements were taxable when acquired or were constructed to replace improvements that were taxable when acquired.

Taxable possessory interests in taxable government-owned real property are subject to taxation under the same general authority of section 1 of article XIII that applies to taxable possessory interests in nontaxable publicly owned property. The taxability of such interests also is affirmed in subdivision (f) of section 11, which provides that "[a]ny taxable interest of any character, other than a lease for agricultural purposes and an interest of a local government, in any land owned by a local government that is subject to taxation pursuant to section 11(a) of this Article shall be taxed in the same manner as other taxable interests."[50]

Given that both extraterritorial government-owned real property and any related taxable possessory interests are potentially subject to taxation under section 11, subdivision (f) of section 11 was added to ensure that, for a given unit of real property, the total of the assessment of the taxable government owned interest and of any taxable possessory interest assessments would not exceed the value of the entire fee simple interest in the unit of real property (i.e., full cash value of the unit of real property).[51]

Recently adopted Rule 29 prescribes a method for determining the limit to the aggregate assessment of taxable possessory interests in a unit of taxable government-owned real property under subdivision (f) of section 11. The fundamental principle of Rule 29 is to allow taxable possessory interest assessment up to the amount of exemption from fair market value provided under the value formulas of section 11, but to exclude from taxable possessory interest assessment any potential additional exemption from fair market value resulting from the base-year-value concept of article XIII A.

Rule 29 operates through two primary concepts: (1) the "section 11 value of taxable government-owned real property;" and (2) the "section 11 taxable possessory interest limitation amount," which

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[50] Note that this constitutional provision specifically excludes agricultural leases in taxable government-owned real property from taxation.
[51] See also *Scott-Free River Expeditions, Inc. v. El Dorado County* (1988) 203 Cal.App.3d 896.

is the limit placed on the aggregate taxable possessory interest assessment under subdivision (f) of section 11.

Section 11 value of taxable government owned real property. The section 11 value of taxable government-owned real property is defined as the sum of the following three values determined as of the lien date:

1. The value of taxable government-owned land, as determined in accordance with subdivisions (b) and (c) of section 11.

2. The value of any taxable replacement improvements, as determined in accordance with subdivision (d) of section 11.

3. The fair market value of any other taxable improvements.

Frequently, the above values, which are based on the value formulas contained in subdivisions (b) through (e) of section 11, are not the same as the assessed values (i.e., the values actually enrolled) because they do not consider the base year value concept of article XIII A of the California Constitution. Section 11 was adopted prior to Article XIII A; consequently, the value formulas of section 11 do not address the concept of base year value.[52] In determining the "section 11 value of taxable government owned real property," factored base year value is not considered. In other words, the "section 11 value of taxable government owned real property" is determined solely in accordance with the provisions of article XIII, section 11, as if article XIII A did not exist.[53]

Section 11 taxable possessory interest limitation amount. The "section 11 taxable possessory interest limitation amount" is the difference between the fair market value of the taxable government-owned real property on the lien date and the section 11 value of the taxable government-owned real property on the lien date. The concept of the fair market value of the taxable government-owned property on the lien date is largely self-explanatory. It may not be clear, however, why the amount subtracted from the fair market value of the taxable government-owned real property should not simply be the assessed value of the taxable government-owned real property rather than the section 11 value of taxable government-owned real property defined in Rule 29 and described above.

One way to view section 11 and article XIII A is that both provide a partial "exemption" from the standard of fair market value. That is, the extent to which subdivisions (b) through (d) of section 11 allow an assessed value below fair market value can be considered a partial exemption;

[52] In *City and County of San Francisco v. County of San Mateo* (1995) 10 Cal.4th 554, the court held that the factored base year value concept of article XIII A applies in the assessment of government owned real property that is taxable under article XIII, section 11.

[53] Section 11 does not provide a special assessment formula for "other taxable improvements" (as that term is defined in Rule 29); improvements in this category are fully taxable to the government owner. Thus, the only potential partial exemption from full cash value that could be provided to these improvements is through article XIII A of the California Constitution (i.e., the base year value concept).

likewise, the extent to which article XIII A allows an assessed value below fair market value also can be considered a partial exemption. To calculate the limitation amount applicable to the assessment of taxable possessory interests in section 11 real property by reference to the assessed values is to potentially include the partial exemption provided by article XIII A in the assessments of these taxable possessory interests. Instead, by calculating the taxable possessory interest limitation amount in a manner that excludes consideration of article XIII A's base year value concept, Rule 29 prevents the allowable assessment of taxable possessory interests in section 11 real property from encompassing the partial exemption under article XIII A that has been provided to the government owner.

Rule 29 only addresses the limit to taxable possessory interest assessment in taxable government-owned real property. Conceivably, however, the unit of real property could also include taxable possessory interests in nontaxable government-owned real property, such as extraterritorial local-government-owned land that was not taxable when acquired. There is no taxable possessory interest limitation amount with regard to nontaxable government-owned property; taxable possessory interests in nontaxable government owned real property may be assessed up to the fair market value of such real property.

If limitation amount exceeded. In addition to defining the taxable possessory interest limitation amount, Rule 29 prescribes a method for reducing the aggregate assessed value of taxable possessory interests in an appraisal unit of taxable government-owned property when the aggregate assessed value of such interests exceeds the taxable possessory interest limitation amount. The most likely occurrence of this is in the event of a decline in value. In essence, Rule 29 provides that the assessed value of each taxable possessory interest shall be reduced pro rata, based on its proportion of the total assessed value of all taxable possessory interests in the appraisal unit, such that the total assessed value of all taxable possessory interests no longer exceeds the taxable possessory interest limitation amount on the lien date.

Supplemental assessments. Because section 11 was adopted prior to article XIII A, the limitation on the assessment of taxable possessory interests in section 11 real property prescribed in section 11 was drafted as if all assessments took place on the lien date only. As a consequence, there is no straightforward or practical method of applying the limitation amount to the supplemental assessment of a newly created taxable possessory interest. That is, the taxable possessory interest limitation amount has only lien date application.

EXAMPLE 5.1

DETERMINATION OF TAXABLE POSSESSORY INTEREST LIMITATION AMOUNT

Subject property: Investment real estate owned by a county employees retirement system and located outside the system's boundaries. The property is subject to assessment under article XIII, section 11, and to taxable possessory interest assessment.

Assuming the relevant lien date values below, determine the taxable possessory interest limitation amount, that is, the property's maximum allowed aggregate taxable possessory interest assessment, as prescribed in Rule 29.

<u>Land</u>:		
Fair market value	$10,000,000	
Factored base year value	3,000,000	
Article XIII, section 11	4,000,000	
Assessed (enrolled) value		$3,000,000
<u>Taxable replacement improvements</u>:		
Fair market value	$6,000,000	
Factored base year value	5,000,000	
Article XIII, section 11	4,000,000	
Assessed (enrolled) value		$4,000,000
<u>Other taxable improvements</u>:		
Fair market value	$3,000,000	
Factored base year value	2,000,000	
Article XIII, section 11	3,000,000	
Assessed (enrolled) value		$2,000,000
<u>Nontaxable improvements</u>:		
Fair market value	$1,000,000	
Factored base year value	-0- (n/a)	
Article XIII, section 11	-0- (n/a)	
Assessed (enrolled) value		-0- (n/a)
<u>Totals (entire unit)</u>:		
Fair market value	$20,000,000	
Factored base year value	10,000,000	
Article XIII, section 11	11,000,000	
Assessed (enrolled) value		<u>$9,000,000</u>

1

EXAMPLE 5.1 (CONTD.)

Solution:

Total real property fair market value		$20,000,000
Less:		
Land—section 11	($4,000,000)	
Taxable replacement improvements—section 11	(4,000,000)	
Other taxable improvements—fair market value	(3,000,000)	
Nontaxable improvements	0	(11,000,000)
Taxable possessory interest limitation amount		$9,000,000

Thus, taxable possessory interests may be assessed up to an aggregate amount of $9,000,000. This is the taxable possessory interest limitation amount.

Note that the limitation amount is not simply equal to the fair market value of the unit minus the assessment made pursuant to article XIII, section 11, and article XIII A. In the example, the limitation amount is $9,000,000, but the fair market value of the unit minus the assessed value of the unit is $11,000,000 ($20,000,000 - $9,000,000).

If a property's aggregate taxable possessory interest assessment exceeds the limitation amount, it must be reduced to the limitation amount. If more than one taxable possessory interest exist, the limitation amount should be allocated among the subject property's existing taxable possessory interests based on their respective fair market values.

For example, assume that the subject property above has two taxable possessory interests, with fair market values on the lien date of $6,000,000 and $4,000,000, respectively. The allocation of the taxable possessory interest limitation amount of $9,000,000 would be as follows:

First taxable possessory interest allocated amount:

$6,000,000/$10,000,000 x $9,000,000 = $5,400,000.

Second taxable possessory interest allocated amount:

$4,000,000/$10,000,000 x $9,000,000 = $3,600,000.

2

TAXABLE POSSESSORY INTERESTS AND INVESTMENT PROPERTY OF PUBLIC EMPLOYEES RETIREMENT SYSTEMS

Most of California's public employees retirement systems hold investment real property, that is, income-producing real property held in a system's investment portfolio for the benefit of the system's beneficiaries. The assessment of this type of real property is governed by the provisions of Government Code section 7510, a specific statute that addresses the issue; California Constitution, article XIII, section 11, which allows for the taxation of real property that is owned by a local government but is located outside its boundaries; and section 107, which together with related regulations, governs the assessment of taxable possessory interests. To correctly assess this type of property, the appraiser must reconcile these several legal provisions.

There are both state and local public employees retirement systems in California. The two major state retirement systems are the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS). There are many local systems operated by the state's counties, cities, and special districts; county systems are by far the most significant in terms of asset value.[54]

The problem of assessing public employees retirement system property can be analyzed in terms of three questions:

1. If a local retirement system (i.e., a system of a county, city, or special district) owns investment real property inside its boundaries, how should the property be assessed?

2. If a local retirement system owns investment real property outside its boundaries, how should the property be assessed?

3. How should the investment real property of a state retirement system, (e.g., CalPERS or CalSTRS) be assessed?[55]

LOCAL PUBLIC EMPLOYEES RETIREMENT SYSTEM: REAL PROPERTY INSIDE SYSTEM'S BOUNDARIES

Subdivision (a) of section 7510 of the Government Code, which applies only to investment real property owned by local public employees retirement systems, contains the concept of an in-lieu fee (i.e., a fee in lieu of property taxes):

[54] Public employees retirement systems are considered legal instrumentalities of the government entities that create them, and a system's boundaries for assessment purposes correspond to that of its parent governmental entity. Thus, a county system has the boundaries of the parent county; a city system the boundaries of the parent city; and a special district system, the boundaries of the parent district. The boundaries of the state public employees retirement systems are the boundaries of the state of California.

[55] In general, investment real property located in California that is owned by a public employees retirement system from another state is taxable as if it were privately owned.

> … [A] public retirement system, which has invested assets in real property and improvements thereon for business or residential purposes for the production of income, shall pay annually to the city or county, in whose jurisdiction the real property is located and has been removed from the secured roll, a fee for general governmental services equal to the difference between the amount that would have accrued as real property secured taxes and the amount of possessory interest unsecured taxes paid for that property.

Absent the above provisions, if a local public employees retirement system acquired investment real property inside its boundaries, its interest would become nontaxable under article XIII, section 3, and the assessment would be "removed from the roll." Subdivision (a) of Section 7510, however, provides for a fee in lieu of property taxes in this case. This in-lieu fee operates to prevent certain investment real property of public employees retirement systems from leaving the assessment roll as exempt.

The in-lieu fee is the difference between (i) the property taxes that would have been collected had the property been assessed under article XIII A ("the amount that would have accrued as real property secured taxes") and (ii) the aggregate amount of property taxes resulting from taxable possessory interest assessments in the property. Thus, the assessor must determine the following when assessing the investment real property of a local public employees retirement system located within the system's boundaries:

1. The assessed value of the property in accordance with article XIII A and related statutes, as if the property were owned by a private entity.

2. The aggregate assessed value of all taxable possessory interests in the property.

3. The value on which the in-lieu fee is based by subtracting No. 2 from No 1.

Subdivision (a)(2) of section 7510 restricts the application of the in-lieu fee, providing that the in-lieu fee does not apply "to any retirement system which is established by a local governmental entity if that entity is presently authorized by statute or ordinance to invest retirement assets in real property." In other words, if a local public retirement system was authorized to invest in real property prior to the effective date of section 7510 (January 1, 1983), any investment real property owned by the system is not subject to the in-lieu fee. This restriction, however, applies to the in-lieu fee only; it is not applicable to the assessment of taxable possessory interests in the real property.

LOCAL PUBLIC EMPLOYEES RETIREMENT SYSTEM: REAL PROPERTY OUTSIDE SYSTEM'S BOUNDARIES

The in-lieu fee of subdivision (a) of section 7510 only applies to investment real property whose value "has been removed from the secured roll." The investment real property of a local public employees retirement system that is outside the system's boundaries is not removed from the roll; rather, it is taxable under the provisions of article XIII, section 11. Therefore, the in-lieu fee does not apply to investment real property of a local public employees retirement system that is located outside its boundaries.

The assessment of the investment real property of a local public employees retirement system that is outside the system's boundaries involves (1) an assessment under article XIII, section 11; and (2) separate assessments for any taxable possessory interests in such property, subject to the limitation set forth in subdivision (f) of section 11. As we discussed in the above section concerning the assessment of taxable possessory interests in section 11 real property, the taxable possessory interest limitation amount operates to establish an aggregate limit to the assessment of taxable possessory interests in section 11 real property.

Thus, the proper assessment of the investment real property of a local public employees retirement system that is located outside the system's boundaries requires that the appraiser determine the following:

1. The assessed values of the publicly owned land and improvements determined according to article XIII, section 11.

2. The values of any taxable possessory interests in the section 11 property, determined in accordance with the applicable statutes and rules governing the assessment of taxable possessory interests, and subject to the taxable possessory interest limitation amount defined in Rule 29.

The unit of real property's entire assessment is the sum of the values in Nos. 1 and 2.

STATE PUBLIC EMPLOYEES RETIREMENT SYSTEMS

As previously stated, subdivision (a) of Government Code section 7510 applies to the assessment of the investment property of local public employees retirement systems only. The assessment of the investment real property of state public employees retirement systems (e.g., the investment real property of CalPERS or CalSTRS) is governed by subdivision (b) of section 7510.

Neither the in-lieu fee nor, by definition, an assessment under article XIII, section 11, applies to investment real property owned by state public employees retirement systems. Nevertheless, under subdivision (b) of section 7510, a taxable possessory interest in the investment real property of a state public employees retirement system (e.g., CalPERS or CalSTRS) is subject to assessment. Subdivision (b)(1) of section 7510 prescribes a specific method for determining the assessed value of each taxable possessory interest in such property:

> [T]he full cash value, as defined in Sections 110 and 110.1 of the Revenue and Taxation Code, of the possessory interest upon which property taxes will be based shall equal the greater of (A) the full cash value of the possessory interest, or (B), if the lessee has leased less than all of the property, the lessee's allocable share of the full cash value of the property that would have been enrolled if the property had been subject to property tax upon acquisition by the state public retirement system.

In other words, for property leased entirely by the lessee, the assessed value is the full cash value of the subject taxable possessory interest. If, however, the lessee has leased less than all the property the assessed value of each taxable possessory interest is the greater of (1) the full cash value of the subject taxable possessory interest or (2) a value based on the possessor's allocable share of the full cash value of the real property, meaning the value that would have been enrolled under article XIII A and related statutes for the entire fee simple interest (i.e., not a partial or possessory interest value). Subdivision (b)(1) further provides that each possessor's "allocable share" shall be a simple allocation based on the square feet leased by the possessor divided by the total leasable square feet of the real property.

Even if a taxable possessory interest in the investment real property of a state public employees retirement system is assessed in an amount equal to its allocable share of the value of the fee simple interest, the lessee (or possessor) as the assessee and the "person affected," must receive notification of the amount of the assessment under section 619 and must be given the opportunity to apply for a reduction in the assessment under the procedures set forth in section 1601 and following and Property Tax Rule 301 and following.

Finally, subdivision (b) of section 7510 also provides that indirect investment in real property by a state public retirement agency—that is, investment in a legal entity that invests in real property as opposed to direct ownership—does not constitute investment in real property for the purposes of section 7510. Legal entities include, but are not limited to, partnerships, joint ventures, corporations, trust, or associations.[56]

[56] An issue related to the subject matter of this section concerns the creation of, and the change in ownership of, taxable possessory interests when leased investment property is acquired by a public employees retirement system. This is discussed in Chapter 4 under "Change in Ownership."

Summary: Assessment of Investment Real Property of Public Employees Retirement Systems

Property Category	Assessment Method	Comments
Investment real property owned by a local public retirement system where the property is within the system's boundaries	• In-lieu fee to local government for difference between the property taxes that would have been levied under the California Constitution, article XIII A, and the property taxes resulting from the aggregate taxable possessory interest assessment. • Taxable possessory interests assessed as all other taxable possessory interests.	• Value based on article XIII A is just as if property had been purchased or was owned by a nongovernmental entity. • Thus, amount of in-lieu fee varies with aggregate taxable possessory interest assessment. • Only situation in which in-lieu fee applies.
Investment real property owned by a local public retirement system where the property is outside the system's boundaries	• Local public retirement system's interest assessed in accordance with California Constitution, article XIII, section 11, and article XIII A. • Taxable possessory interests assessed as all other taxable possessory interests but also subject to the provisions of subdivision (f) of section 11 and the taxable possessory interest limitation amount of Rule 29.	• Sum of article XIII, section 11, assessment and aggregate taxable possessory interest assessment subject to taxable possessory interest limitation amount of Rule 29. • In-lieu fee does not apply.
Investment real property owned by a state public retirement system (e.g., CalPERS or CalSTRS)	• Taxable possessory interest assessment is the greater of (1) taxable possessory interest value or (2) possessor's allocable share of full cash value that would have been enrolled had property been subject to taxation when acquired by the state public retirement system (i.e., what the property's taxable value would have been under the provisions of article XIII A). • Each private possessor's allocable share based on each possessor's leasable area divided by property's total leasable area.	• Assessment for taxable possessory interests only. Section 11 does not apply. • In-lieu fee does not apply.

PROPERTY OF THE CALIFORNIA DEPARTMENT OF TRANSPORTATION

The California Department of Transportation (CalTrans) holds title to real property needed for future state highway purposes and real property once thought needed for that purpose but now awaiting sale or exchange. If such property is leased to a private possessor, a taxable possessory interest is created. Under section 104.13 of the California Streets and Highway Code, CalTrans must provide an annual list of this property to the assessor in each county in which such property is located; and in turn, the assessor must provide the possessory interest tax bill for each property directly to CalTrans, which is responsible for the payment of the tax.

Section 104.13 also provides that, instead of the information required in Revenue and Taxation Code section 107.6 (i.e., the required notice from the public owner to the private possessor that the property interest created may create a taxable possessory interest and that the possessor is responsible for any taxes levied on the interest), the CalTrans lease must contain a provision stating that CalTrans will pay all possessory interest taxes and that the rent charged by CalTrans reflects the cost of this provision.[57]

In addition to the specific real property referenced in section 104.13, CalTrans owns other real property in which a taxable possessory interest may exist. Taxable possessory interests in this real property are subject to the provisions of Revenue and Taxation Code section 107.6 and to the provisions of Revenue and Taxation Code section 480.6 (i.e., the requirement that a public entity file an annual real property usage report with the local assessor that describes the taxable possessory interests created by the public entity).

PROPERTY LEASED FROM REDEVELOPMENT AGENCIES

Under the California Community Development Law (Health and Safety Code sections 33000 and following), the legislative body of a city, county, or city and county may create a public entity known as a "redevelopment agency." Redevelopment agencies carry out a variety of real estate-related activities aimed at promoting the development and redevelopment of blighted areas, expanding the supply of low- and moderate-income housing, creating economic growth, and generally improving the quality of the urban environment.

Section 33673 of the Health and Safety Code prescribes how real property owned by a redevelopment agency and leased for private use should be assessed:

> Whenever property in any redevelopment project has been redeveloped and thereafter is leased by the redevelopment agency to any person or persons or whenever the agency leases real property in any redevelopment project to any person or persons for redevelopment, the property shall be assessed and taxed *in*

[57] This is a departure from the typical circumstance in which the possessory interest tax is paid by the lessee in addition to rent. For property subject to Streets and Highway Code section 104.13, the income to be capitalized (i.e., the rental income) includes an amount for property taxes; therefore, a property tax component should be added to the discount rate.

> the same manner as privately owned property, and the lease or contract shall provide that the lessee shall pay taxes upon the assessed value of the entire property and not merely the assessed value of his or its leasehold interest.

A taxable possessory interest is created when property that is owned by a redevelopment agency is leased for private use. The meaning of the above statute is that such an interest should be assessed as if owned in fee simple, that is, the assessed value should include the value of the reversionary interest retained by the redevelopment agency. In determining this value, as with other property, the assessor must consider any enforceable restrictions to which the property is subject, which in the case of a taxable possessory interest also include the terms contained in the lease or other form of legal instrument associated with the taxable possessory interest.[58]

If a taxable possessory interest involves a portion of the total leasable area, the assessed value of the taxable possessory interest should reflect a pro-rata allocation of the property's total fee simple value. Typically, the value allocation would be based on leasable area. In other words, the statute does not subject a possessor-lessee to assessment based on the fee simple value of the entire real property if the possessor-lessee occupies only a portion of the real property.

In general, under applicable constitutional and statutory provisions, assessors are required to assess real property, which includes taxable possessory interests, at the lesser of current fair market value or factored base year value. Some may argue that section 33673 results in assessments of taxable possessory interests in redevelopment agency property at assessed values above the fair market values of such interests (due to the inclusion in the assessed value of the value of the nontaxable reversionary interest of the public owner). Under California Constitution, article III, section 3.5, however, neither the Board nor an assessor, acting administratively, may refuse to enforce a statue on the grounds that it is unconstitutional or violates another statute. In the view of Board staff, the language of section 33673 is clear, and until an appellate court holds that the language is unconstitutional or the Legislature amends Health and Safety Code section 33673, the statute must be implemented as it is written.

SECTION 107.7: VALUATION OF CABLE TELEVISION INTERESTS

Section 107.7 codified case law holding that a cable television company's rights of way in publicly owned real property (for placement of wires, conduits, and related equipment) contained in a cable television franchise or license constitutes a taxable possessory interest.[59] Section 107.7 also contains special provisions relating to the assessment of "cable television possessory interests." These special provisions are briefly summarized below:

1. A cable television possessory interest must be valued in a manner consistent with section 401. This provision means that a cable television possessory interest must be assessed at

[58] See also Letter To Assessors 77/73, May 16, 1977.

[59] See *Cox Cable San Diego, Inc. v. San Diego County* (1986) 185 Cal.App.3d 368; *Stanislaus County v. Assessment Appeals Board* (1989) 213 Cal.App.3d 1445.

its full value—that is, not at a fraction, or ratio, of its full value—and is simply a reiteration of a general assessment requirement.

2. The preferred method for determining the assessed value of a cable television taxable possessory interest is the income approach—that is, by "capitalizing the annual rent, using an appropriate capitalization rate." For the purpose of section 107.7, "annual rent" is defined as the portion of the annual franchise fee determined to be payment for the cable television taxable possessory interest. If the assessor does not use a portion of the franchise fee as an estimate of the economic rent for the taxable possessory interest, the taxable possessory interest assessment loses the usual presumption of correctness.

3. If the assessor uses the comparative sales approach, and the comparable sales data reflects the sale of a cable television possessory interest in combination with other property that includes, but is not limited to, intangible assets or rights, the assessment also loses its presumption of correctness.

4. Intangible assets or rights of a cable television system are exempt from property taxation; however, a cable television possessory interest may be assessed by assuming the presence of intangible assets or rights necessary to put the cable television possessory interest to beneficial or productive use in the operation of a cable television system. The statute provides a not-all-inclusive list of intangible assets or rights that may be associated with the operation of a cable television system. In essence, this provision reiterates subdivisions (d) and (e) of section 110.

5. Finally, as a reporting requirement associated with a change in ownership of a cable television possessory interest, section 107.7 states that the appropriate legal entity must provide, if requested by the assessor and if applicable, the following: (1) a confirmation of the sales price, (2) an allocation of the sales price among the counties, and (3) the gross revenue and franchise fee expenses of the cable television system by county.

SECTION 107.8: LEASE-LEASEBACK TRANSACTIONS INVOLVING A PUBLIC OWNER OF REAL PROPERTY

A lease-leaseback of publicly owned real property occurs when a the public owner leases real property to a private possessor and then subleases it back from the private possessor (i.e., the private possessor is the sublessor, and the public owner the sublessee). Under conditions specified in section 107.8, the lease-leaseback of publicly owned real property does not constitute a taxable possessory interest because the criterion of "independence" is not met; that is, the lessee's (i.e., the private possessor's) interest does not constitute a taxable possessory interest.

Pursuant to section 107.8, a lease-leaseback transaction of publicly owned real property does not create a taxable possessory interest if all of the following conditions are satisfied:

1. Upon execution of its lease, the lessee (i.e., the private possessor) is simultaneously obligated to sublease the property to the public owner of the property for all or substantially all of the lease period ("all or substantially all" meaning at least 85 percent of the lease period).

2. The lessee may not exercise authority and exert control over the management or operation of the property separate and apart from the policies, statutes, ordinances, rules and regulations of the public owner.

3. The lessee agrees in writing in the sublease that the public owner has the right to repurchase all of the lessee's rights in the lease.

4. The lessee cannot receive rent or other amounts from the public owner under the sublease (including any amounts due with respect to any repurchase) the present value of which, at the time the lease is entered into, exceeds the present value of the rent or other amounts payable by the lessee under the lease.

SECTION 107.9: OTHER TAXABLE POSSESSORY INTERESTS IN PUBLICLY OWNED AIRPORTS

Section 107.9 establishes the existence of a taxable possessory interest in publicly owned airports held by operators of certificated aircraft (i.e., commercial airlines) that is in addition to any other taxable possessory interests in terminal, hangar, cargo, or other site-specific facilities ("excluded possessory interests") held by such operators. With the exception of site-specific assessments, which are separately assessed, the assessment for all other taxable real property rights in publicly owned airports held by commercial airlines is subsumed into this additional, "general purpose," or "unitary," taxable possessory interest assessment. [60]

Section 107.9 prescribes a detailed method of valuation that, if followed by assessors, confers a presumption of correctness to the assessment. If, on the other hand, the prescribed method is not followed, the assessment's usual presumption of correctness is lost.

In brief, the prescribed method requires that the full cash value of the defined taxable possessory interest for 1998 and subsequent tax years be determined using a direct income capitalization approach that capitalizes the net economic rent. The values for the variables in the income approach (i.e., net economic rent, expense ratio, capitalization rate, and term of possession) are defined in the statute, with their initial values established using data from 1996 assessments, or, if the county's 1996 assessment did not include "landing rights," from airport data derived from the 1995-96 tax year. Subsequent annual adjustments to the assessments are based on changes in the

[60] Section 107.9 is based on a settlement agreement in 1998 between 18 counties and 13 airlines who were engaged in a dispute relating both to the valuation of commercial aircraft (business personal property) and to the taxability and valuation of airline real property interests in publicly-owned airports, including the taxable possessory interests formerly known as "landing rights." For additional background, see Letter To Assessors 86/75.

"standardized" 1996 values. For more detailed information about the valuation method, see the statute.

Consistent with article XIII A of the California Constitution and related statutes, the annual value determined in accordance with the section 107.9's prescribed method should not be enrolled if it exceeds the factored base year value; that is, the lower of the statute's formulaic value or the factored base year value should be enrolled.

SECTION 201.5: TAXABLE POSSESSORY INTERESTS IN PROPERTY ACQUIRED BY OR FOR THE CALIFORNIA POLLUTION CONTROL FINANCING AGENCY

Section 201.5 states that a possessory interest in property acquired by or for the California Pollution Control Financing Authority is subject to taxation. In this regard, as we noted in Chapter 2, section 201.5 also provides that such taxable possessory interests may exist in real or personal property. This is the only instance in which a taxable possessory interest may exist in personal property.

Subdivision (b) of section 201.5 also states that if the amount of property tax that results from the taxable possessory interest assessment is less than the amount that would have resulted had the "participating party" owned the pollution control facility (i.e., the amount that would have been collected had the fee simple or entire ownership interest in the property been assessed at full cash value), then the agreement between the parties must provide that the amount of the difference will be paid by the participating party to the tax collector at the same time that the property tax is paid.

APPENDIX A: STATUTES

Revenue and Taxation Code Sections[61]

60. Meaning of "change in ownership." A "change in ownership" means a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest. **61. "Change in ownership" includes.** Except as otherwise provided in Section 62, change in ownership, as defined in Section 60, includes, but is not limited to:

(a) The creation, renewal, sublease, assignment, or other transfer of the right to produce or extract oil, gas, or other minerals regardless of the period during which the right may be exercised. The balance of the property, other than the mineral rights, shall not be reappraised pursuant to this section.

(b) The creation, renewal, extension, or assignment of a taxable possessory interest in tax exempt real property for any term. For purposes of this subdivision:

(1) "Renewal" and "extension" do not include the granting of an option to renew or extend an existing agreement pursuant to which the term of possession of the existing agreement would, upon exercise of the option, be lengthened, whether the option is granted in the original agreement or subsequent thereto.

(2) Any "renewal" or "extension" of a possessory interest during the reasonably anticipated term of possession used by the assessor to value that interest does not cause a change in ownership until the end of the reasonably anticipated term of possession used by the assessor to value that interest. At the end of the reasonably anticipated term of possession used by the assessor, a new base year value, based on a new reasonably anticipated term of possession, shall be established for the possessory interest.

(3) "Assignment" of a possessory interest means the transfer of all rights held by a transferor in a possessory interest.

(c) (1) The creation of a leasehold interest in taxable real property for a term of 35 years or more (including renewal options), the termination of a leasehold interest in taxable real property which had an original term of 35 years or more (including renewal options), and any transfer of a leasehold interest having a remaining term of 35 years or more (including renewal options); or (2) any transfer of a lessor's interest in taxable real property subject to a lease with a remaining term (including renewal options) of less than 35 years.

Only that portion of a property subject to that lease or transfer shall be considered to have undergone a change in ownership.

For the purpose of this subdivision, for 1979-80 and each year thereafter, it shall be conclusively presumed that all homes eligible for the homeowners' exemption, other than manufactured homes located on rented or leased land and subject to taxation pursuant to Part 13 (commencing with Section 5800), that are on leased land have a renewal option of at least 35 years on the lease of that land, whether or not in fact that renewal option exists in any contract or agreement.

(d) (1) (A) A sublease of a taxable possessory interest in tax-exempt real property for a term, including renewal options, that exceeds half the length of the remaining term of the leasehold, including renewal options.

[61] This appendix contains the statutes directly relevant to the assessment of taxable possessory interests as of the date of publication of this manual. It is not possible to reissue or correct the manual every time a statutory provision changes, so the reader is cautioned to review current statutes.

(B) The termination of a sublease of a taxable possessory interest in tax-exempt property with an original term, including renewal options, that exceeds half the length of the remaining term of the leasehold, including renewal options.

(C) Any transfer of a sublessee's interest with a remaining term, including renewal options, that exceeds half of the remaining term of the leasehold.

(2) Any transfer of a possessory interest in tax-exempt real property subject to a sublease with a remaining term, including renewal options, that does not exceed half the remaining term of the leasehold, including renewal options.

(e) The creation, transfer, or termination of any joint tenancy interest, except as provided in subdivision (f) of Section 62, and in Section 63 and Section 65.

(f) The creation, transfer, or termination of any tenancy-in-common interest, except as provided in subdivision (a) of Section 62 and in Section 63.

(g) Any vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63.

(h) Any interests in real property that vest in persons other than the trustor (or, pursuant to Section 63, his or her spouse) when a revocable trust becomes irrevocable.

(i) The transfer of stock of a cooperative housing corporation, vested with legal title to real property that conveys to the transferee the exclusive right to occupancy and possession of that property, or a portion thereof. A "cooperative housing corporation" is a real estate development in which membership in the corporation, by stock ownership, is coupled with the exclusive right to possess a portion of the real property.

(j) The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person.

62. "Change in ownership" exclusions. Change in ownership shall not include:

(a) (1) Any transfer between coowners that results in a change in the method of holding title to the real property transferred without changing the proportional interests of the coowners in that real property, such as a partition of a tenancy in common.

(2) Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, that results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer. The provisions of this paragraph shall not apply to transfers also excluded from change in ownership under the provisions of subdivision (b) of Section 64.

(b) Any transfer for the purpose of perfecting title to the property.

(c) (1) The creation, assignment, termination, or reconveyance of a security interest; or (2) the substitution of a trustee under a security instrument.

(d) Any transfer by the trustor, or by the trustor's spouse, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust, or (2) the trust is revocable; or any transfer by a trustee of such a trust described in either clause (1) or (2) back to the trustor; or, any creation or termination of a trust in which the trustor retains the reversion and in which the interest of others does not exceed 12 years duration.

(e) Any transfer by an instrument whose terms reserve to the transferor an estate for years or an estate for life. However, the termination of such an estate for years or estate for life shall constitute a change in ownership, except as provided in subdivision (d) and in Section 63.

(f) The creation or transfer of a joint tenancy interest if the transferor, after the creation or transfer, is one of the joint tenants as provided in subdivision (b) of Section 65.

(g) Any transfer of a lessor's interest in taxable real property subject to a lease with a remaining term (including renewal options) of 35 years or more. For the purpose of this subdivision, for 1979-80 and each year thereafter, it shall be conclusively presumed that all homes eligible for the homeowners' exemption, other than mobilehomes located on rented or leased land and subject to taxation pursuant to Part 13 (commencing with Section 5800), that are on leased land and have a renewal option of at least 35 years on the lease of that land, whether or not in fact that renewal option exists in any contract or agreement.

(h) Any purchase, redemption, or other transfer of the shares or units of participation of a group trust, pooled fund, common trust fund, or other collective investment fund established by a financial institution.

(i) Any transfer of stock or membership certificate in a housing cooperative that was financed under one mortgage, provided that mortgage was insured under Section 213, 221(d)(3), 221(d)(4), or 236 of the National Housing Act, as amended, or that housing cooperative was financed or assisted pursuant to Section 514, 515, or 516 of the Housing Act of 1949 or Section 202 of the Housing Act of 1959, or the housing cooperative was financed by a direct loan from the California Housing Finance Agency, and provided that the regulatory and occupancy agreements were approved by the governmental lender or insurer, and provided that the transfer is to the housing cooperative or to a person or family qualifying for purchase by reason of limited income. Any subsequent transfer from the housing cooperative to a person or family not eligible for state or federal assistance in reduction of monthly carrying charges or interest reduction assistance by reason of the income level of that person or family shall constitute a change of ownership.

(j) Any transfer during the period March 1, 1975, to March 1, 1981, between coowners in any property that was held by them as coowners for all or part of that period, and which was eligible for a homeowner's exemption during the period of the coownership, notwithstanding any other provision of this chapter. Any transferee whose interest was revalued in contravention of the provisions of this subdivision shall obtain a reversal of that revaluation with respect to the 1980-81 assessment year and thereafter, upon application to the county assessor of the county in which the property is located filed on or before March 26, 1982. No refunds shall be made under this subdivision for any assessment year prior to the 1980-81 fiscal year.

(k) Any transfer of property or an interest therein between a corporation sole, a religious corporation, a public benefit corporation, and a holding corporation as defined in Section 23701h holding title for the benefit of any of these corporations, or any combination thereof (including any transfer from one such entity to the same type of entity), provided that both the transferee and transferor are regulated by laws, rules, regulations, or canons of the same religious denomination.

(*l*) Any transfer, that would otherwise be a transfer subject to reappraisal under this chapter, between or among the same parties for the purpose of correcting or reforming a deed to express the true intentions of the parties, provided that the original relationship between the grantor and grantee is not changed.

(m) Any intrafamily transfer of an eligible dwelling unit from a parent or parents or legal guardian or guardians to a minor child or children or between or among minor siblings as a result of a court order or judicial decree due to the death of the parent or parents. As used in this subdivision, "eligible dwelling unit" means the dwelling unit that was the principal place of residence of the minor child or children prior to the transfer and remains the principal place of residence of the minor child or children after the transfer.

(n) Any transfer of an eligible dwelling unit, whether by will, devise, or inheritance, from a parent or parents to a child or children, or from a guardian or guardians to a ward or wards, if the child, children, ward, or wards have been disabled, as provided in subdivision (e) of Section 12304 of the Welfare and Institutions Code, for at least five years preceding the transfer and if the child, children, ward, or wards have adjusted gross income that, when combined with the adjusted gross income of a spouse or spouses, parent or parents, and child or children, does not exceed twenty thousand dollars ($20,000) in the year in which the transfer occurs. As used in this subdivision, "child" or "ward" includes a minor or an adult. As used in this subdivision, "eligible dwelling unit" means the dwelling unit that was the principal place of residence of the child or children, or ward or wards for at least five years preceding the transfer and remains the principal place of residence of the child or children, or ward or wards after the transfer. Any transferee whose property was reassessed in contravention of the provisions of this subdivision for the 1984-85 assessment year shall obtain a reversal of that reassessment upon application to the county assessor of the county in which the property is located. Application by the transferee shall be made to the assessor no later than 30 days after the later of either the transferee's receipt of notice of reassessment pursuant to Section 75.31 or the end of the 1984-85 fiscal year.

(o) Any transfer of a possessory interest in tax-exempt real property subject to a sublease with a remaining term, including renewal options, that exceeds half the length of the remaining term of the leasehold, including renewal options.

75.5. "Property." "Property" means and includes manufactured homes subject to taxation under Part 13 (commencing with Section 5800) and real property, other than the following: (a) Fixtures that are normally valued as a separate appraisal unit from a structure. (b) Newly created taxable possessory interests, established by month-to-month agreements in publicly owned real property, having a full cash value of fifty thousand dollars ($50,000) or less.

107. "Possessory interests." "Possessory interests" means the following:

(a) Possession of, claim to, or right to the possession of land or improvements that is independent, durable, and exclusive of rights held by others in the property, except when coupled with ownership of the land or improvements in the same person. For the purposes of this subdivision:

(1) "Independent" means the ability to exercise authority and exert control over the management or operation of the property or improvements, separate and apart from the policies, statutes, ordinances, rules, and regulations of the public owner of the property or improvements. A possession or use is independent if the possession or operation of the property is sufficiently autonomous to constitute more than a mere agency.

(2) "Durable" means for a determinable period with a reasonable certainty that the use, possession, or claim with respect to the property or improvements will continue for that period.

(3) "Exclusive" means the enjoyment of a beneficial use of land or improvements, together with the ability to exclude from occupancy by means of legal process others who may interfere with that enjoyment. For purposes of this paragraph, "exclusive use" includes the following types of use in property:

(A) Sole occupancy or use of property or improvements.

(B) Use as a cotenant.

(C) Concurrent use by a person who has a primary or prevailing right to use property or improvements at any time.

(D) Concurrent uses by persons making qualitatively different uses of property or improvements.

(E) Concurrent use by persons engaged in similar uses that diminish the quantity or quality of the property or improvements.

(F) Concurrent use that does not diminish the quantity or quality of the property or improvements, if the number of those concurrent use grants is restricted.

A use of property or improvements that does not contain one of the elements in subparagraphs (A) to (F), inclusive, shall be rebuttably presumed to be a nonexclusive use.

(b) Taxable improvements on tax-exempt land.

Any possessory interest may, in the discretion of the county board of supervisors, be considered as sufficient security for the payment of any taxes levied thereon and may be placed on the secured roll.

Leasehold estates for the production of gas, petroleum and other hydrocarbon substances from beneath the surface of the earth, and other rights relating to these substances which constitute incorporeal hereditaments or profits a prendre, are sufficient security for the payment of taxes levied thereon. These estates and rights shall not be classified as possessory interests, but shall be placed on the secured roll.

If the tax on any possessory interest or leasehold estate for the production of gas, petroleum and other hydrocarbon substances is unpaid when any installment of secured taxes become delinquent, the tax collector may use those collection procedures which are available for the collection of assessments on the unsecured roll.

If the tax on any possessory interest or leasehold estate for the production of gas, petroleum and other hydrocarbon substances remains unpaid at the time set for the declaration of default for taxes carried on the secured roll, the possessory interest tax together with any penalty and costs which may be accrued thereon while on the secured roll shall be transferred to the unsecured roll.

107.1. Valuation of certain possessory interests. The full cash value of a possessory interest, when arising out of a lease of exempt property, is the excess, if any, of the value of the lease on the open market, as determined by the formula contained in the case of *De Luz* Homes, Inc. v. County of San Diego (1955), 45 Cal. 2d 546, over the present worth of the rentals under said lease for the unexpired term thereof.

A possessory interest taxable under the provisions of this section shall be assessed to the lessee on the same basis or percentage of valuation employed as to other tangible property on the same roll.

This section applies only to possessory interests created prior to the date on which the decision of the California Supreme Court in *De Luz* Homes, Inc. v. County of San Diego (1955), 45 Cal. 2d 546, became final. It does not, however, apply to any of such interests created prior to that date that thereafter have been, or may hereafter be, extended or renewed, irrespective of whether the renewal or extension is provided for in the instrument creating the interest.

This section does not apply to leasehold estates for the production of gas, petroleum and other hydrocarbon substances from beneath the surface of the earth, and other rights relating to such substances which constitute incorporeal hereditaments or profits a prendre.

107.2. Valuation of certain oil and gas interests. The full cash value of leasehold estates in exempt property for the production of gas, petroleum and other hydrocarbon substances from beneath the surface of the earth, and all other taxable rights to produce gas, petroleum and other hydrocarbon substances from exempt property (all of which rights are hereinafter in this section referred to as "such oil and gas interests"), is the value of such oil and gas interests exclusive of the value of any royalties or other rights to share in production from exempt property owned by any tax-exempt entity, whether receivable in money or property and whether measured by or based upon production or income or both.

This section applies to such oil and gas interests created prior to the date on which the decision in *De Luz* Homes, Inc. v. County of San Diego (1955) 45 Cal. 2d 546, became final. This section does not, however, apply to any of such oil and gas interests created prior to such date which have been after such date or are hereafter extended or renewed, unless such extension or renewal is pursuant to authority in a contract, lease, statute, regulation, city charter, ordinance, or other source, which authority permits no reduction of the rate of royalty or other right to share in production on grounds of an increase in the assessed valuation of such oil and gas interest. Moreover, this section does not apply to any of such oil and gas interests if the rate of royalties or other right to share in production has, prior to the effective date of this section, been reduced to adjust for the fact that certain assessors have valued such oil and gas interests without excluding the value of said royalties or other rights to share in production.

107.3. Valuation of certain oil and gas interests? extended. The full cash value of leasehold estates in exempt property for the production of gas, petroleum and other hydrocarbon substances from beneath the surface of the earth and all other taxable rights to produce gas, petroleum and other hydrocarbon substances from exempt property (all of which rights are hereinafter in this section referred to as "such oil and gas interests"), is the value of such oil and gas interests, exclusive of the value of any royalties or other rights to share in production from exempt property owned by any tax-exempt entity, whether receivable in money or property and whether measured by or based upon production or income or both.

This section applies to:

(a) Such oil and gas interests created prior to the date on which the decision in *De Luz* Homes, Inc. *v*. County of San Diego (1955) 45 Cal. 2d 546, became final to which Section 107.2 of this code does not apply because said interests were extended or renewed on or before July 26, 1963.

(b) Such oil and gas interests created on or after the date on which said decision become final and on or before July 26, 1963.

This section does not, however, apply to any of such oil and gas interests extended or renewed after July 26, 1963, unless such extension or renewal is pursuant to authority in a contract, lease, statute, regulation, city charter, ordinance or other source which authority permits no reduction of the rate of royalty or other right to share in production upon the ground of an increase in the assessed valuation of such oil and gas interest. Moreover, this section does not apply to any of such oil and gas interests if the rate of royalties or other right to share in production has, prior to the effective date of this section, been reduced to adjust for the fact that certain assessors have valued such oil and gas interests without excluding the value of said royalties or other rights to share in production.

107.6. Notification of taxability of possessory interest. (a) The state or any local public entity of government, when entering into a written contract with a private party whereby a possessory interest subject to property taxation may be created, shall include, or cause to be included, in that contract, a statement that the property interest may be subject to property taxation if created, and that the party in whom the possessory interest is vested may be subject to the payment of property taxes levied on the interest.

(b) Failure to comply with the requirements of this section shall not be construed to invalidate the contract. The private party may recover damages from the contracting state or local public entity, where the private party can show that without the notice, he or she had no actual knowledge of the existence of a possessory interest tax.

The private party is rebuttably presumed to have no actual knowledge of the existence of a possessory interest tax.

In order to show damages, the private party need not show that he or she would not have entered the contract but for the failure of notice.

(c) For purposes of this section:

(1) "Possessory interest" means any interest described in Section 107.

(2) "Local public entity" shall have the same meaning as that set forth in Section 900.4 of the Government Code and shall include school districts and community college districts.

(3) "State" means the state and any state agency as defined in Section 11000 of the Government Code and Section 89000 of the Education Code.

(4) "Damages" mean the amount of the possessory interest tax for the term of the contract.

107.7. Valuation of cable television interests. (a) When valuing possessory interests in real property created by the right to place wires, conduits, and appurtenances along or across public streets, rights-of-way, or public easements contained in a cable television franchise or license granted pursuant to Section 53066 of the Government Code (a "cable television possessory interest"), the assessor shall value these possessory interests consistent with the requirements of Section 401. The methods of valuation shall include, but not be limited to, the comparable sales method, the income method (including, but not limited to, capitalizing rent), or the cost method.

(b) (1) The preferred method of valuation of a cable television possessory interest is capitalizing the annual rent, using an appropriate capitalization rate.

(2) For purposes of this section, the annual rent shall be that portion of that franchise fee received by the franchising authority that is determined to be payment for the cable television possessory interest for the actual remaining term or the reasonably anticipated term of the franchise or license or the appropriate economic rent. If the assessor does not use a portion of the franchise fee as the economic rent, the resulting assessments shall not benefit from any presumption of correctness.

(c) If the comparable sales method, which is not the preferred method, is used by the assessor to value a cable television possessory interest when sold in combination with other property including, but not limited to, intangible assets or rights, the resulting assessments shall not benefit from any presumption of correctness.

(d) Intangible assets or rights of a cable television system are not subject to ad valorem property taxation. These intangible assets or rights, include, but are not limited to: franchises or licenses to construct, operate, and maintain a cable television system for a specified franchise term (excepting therefrom that portion of the franchise or license which grants the possessory interest), subscribers, marketing, and programming contracts, nonreal property lease agreements, management and operating systems, a work force in place, going concern value, deferred, startup, or prematurity costs, covenants not to compete, and goodwill. However, a cable television possessory interest may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the cable television possessory interest to beneficial or productive use in an operating cable television system.

(e) Whenever any change in ownership of a cable television possessory interest occurs, the person or legal entity required to file a statement pursuant to Section 480, 480.1, or 480.2, shall, at the request of the assessor, provide as a part of that statement the following, if applicable: confirmation of the sales price; allocation of the sales price among the counties; and gross revenue and franchise fee expenses of the cable television system by county. Failure to provide this information shall result in a penalty as provided in Section 482, except that the maximum penalty shall be five thousand dollars ($5,000).

107.8. Lease-leaseback agreements. (a) For purposes of applying subdivision (a) of Section 107 to a lease-leaseback of publicly owned real property, the possession of, claim to, or right to the possession of, land or improvements pursuant to a lease is not independent if the lessee (1) is obligated simultaneously to sublease the property to the public owner of the property for all or substantially all of the lease period, (2) may not exercise authority and exert control over the management or operation of the property separate and apart from the policies, statutes, ordinances, rules and regulations of the public owner, (3) provides as part of the sublease that the public owner has the right to repurchase all of the lessee's rights in the lease, and (4) cannot receive rent or other amounts from the public owner under the sublease (including any amounts due with respect to any repurchase) the present value of which, at the time the lease is entered into, exceeds the present value of the rent or other amounts payable by the lessee under the lease.

(b) For purposes of subdivision (a), the term "all or substantially all" means at least 85 percent.

107.9. Valuation of interests in publicly owned airports. (a) In addition to any taxable real property interests that an operator of certificated aircraft has at a publicly owned airport that are interests stated in a written agreement for terminal, cargo, hangar, automobile parking lot, storage and maintenance facilities and other buildings and the land thereunder leased in whole or in part by an airline (hereafter the "excluded possessory interests"), there exists an additional taxable possessory interest conferred upon an operator of certificated aircraft at a publicly owned airport.

(b) Notwithstanding any other provision of law relating to valuation, for assessments for the 1998-99 fiscal year, and each fiscal year thereafter, (1) regular assessments of all taxable real property interests of the operator of certificated aircraft at a publicly owned airport, other than the excluded possessory interests, and (2) timely escape assessments upon the real property interests governed by this section issued on or after April 1, 1998, pursuant to Sections 531 and 531.2, shall be presumed to be valued and assessed at full cash value for these interests only if the assessor uses the following direct income approach in capitalizing net economic rent:

(1) The economic rent shall be computed by using one-half of the landing fee rate used to calculate the 1996-97 assessment for real property interests, other than excluded possessory interests, multiplied by the aggregate weight of landings by the operator for the airport's fiscal year prior to the 1996 lien date. The one-half of the landing fee rate used to compute the 1996-97 economic rent shall be annually adjusted in accordance with the percentage change, rounded to the nearest one-thousandth of 1 percent, from October of the prior fiscal year to October of the current fiscal year in the California Consumer Price Index for all items, as determined by the California Department of Industrial Relations, except that in no instance shall this adjusted rate exceed one-half of the airport's actual landing fee rate for the last full fiscal year. The economic rent shall also be adjusted in proportion to the increase or decrease in the aggregate weight of landings by the operator for the last full fiscal year at each airport in the taxing county. In the case of a new operator, the economic rent shall be determined by reference to a similarly situated operator.

(2) The expense ratio shall be the ratio used by each county for the 1996 lien date.

(3) The capitalization rates shall not exceed, or be less than, the rates used by each county for the 1996 lien date, except that they shall be annually adjusted in proportion to the changes in the "Going-in Cap Rate; All Types" as published by the Real Estate Research Corporation, and, as so adjusted, shall be rounded to the nearest one-half percent. If this information ceases to be published by the Real Estate Research Corporation or the format significantly changes, a publication or adjustment agreed to by the airlines and the taxing counties shall be substituted.

(4) The term of possession for each operator shall be the term used by each county to calculate the 1996-97 assessment, but shall not exceed a maximum term of 20 years. Subject to paragraphs (1) to (3), inclusive, of subdivision (b) of Section 61 as applied to interests subject to this subdivision, changes of ownership and term of possessions shall be determined as follows:

(A) In the case of the creation, renewal, extension or assignment of an operating agreement or permit, without the concurrent creation, renewal, extension or assignment of a terminal, hangar, or cargo facility agreement, no change in ownership will be presumed to have occurred and the term of possession shall be the term used by each county for their 1996-97 assessments, not to exceed a maximum of 20 years.

(B) In the case of the creation, renewal, extension or assignment of a terminal, hangar, or cargo facility agreement, a change in ownership will be presumed to have occurred and the term of possession shall be the actual term stated in the written terminal, hangar, or cargo facility agreement, provided that the term shall not be less than 10 years or exceed 15 years.

(C) In the case of any operator without a terminal, hangar, or cargo facility agreement, the actual creation, renewal, extension or assignment of a written operating agreement or permit shall constitute a change in ownership and the actual term of the operating agreement for that carrier will be used, provided that the term shall not be less than 5 years or exceed more than 15 years.

(5) Nothing in this subdivision is intended to apply to the determination of a term of possession for a possessory interest in an excluded possessory interest.

(c) Notwithstanding subdivision (b), in a county in which 1995-96 landing fees were not used to calculate the 1996-97 assessment, the county shall benefit from the presumption of correctness set forth in subdivision (b) only if the assessor uses the following direct income approach in capitalizing net economic rent:

(1) The calculations required in subdivision (b) are performed using the assessment that would have been derived in the 1996-97 fiscal year had the assessor followed the methodology set forth in subdivision (b) using actual airport data for the 1995-96 fiscal year.

(2) If any portion of the airport's landing fee rate for the 1995-96 fiscal year was in dispute and resulted in the creation of an escrow account for a portion of the landing fees paid, that portion of the landing fee rate attributable to the escrowed funds shall not be included in the calculations performed in paragraph (1). However, if the dispute is resolved, in whole or in part, in favor of the publicly owned airport and all or a portion of the escrowed funds are released to the airport, the assessor shall, without regard to any other statutorily imposed time limitation, be entitled to recalculate the assessments required by this subdivision using an adjusted landing fee rate that reflects a final decision on the disposition of escrowed funds to produce escape assessments for all affected years.

(d) Value shall be determined as follows:

(1) Economic rent shall be calculated by applying the expense ratio described in paragraph (2) of subdivision (b) to reduce gross income determined pursuant to paragraph (1) of subdivision (b) or (c) and paragraph (2) of subdivision (c) to arrive at an amount that shall be deemed to be equivalent to economic rent.

(2) Economic rent, as so determined, shall be capitalized for the term provided for in paragraph (4) of subdivision (b) at the capitalization rate determined in accordance with paragraph (3) of subdivision (b).

(e) Assessments under this section shall not exceed the factored base year value established under Article XIIIA of the California Constitution. However, adjustments made in aggregate landing weights under this section are deemed to be a valid basis for adjusting the base year value to the extent of the percentage change in landed weights for purposes of Article XIIIA of the California Constitution.

Pursuant to Section 65.1, adjustments in aggregate landing weights shall not be considered a change in ownership or a basis for applying a new term of possession in the airlines' preexisting real property interest.

155.20. Exemption of property having low value. (a) (Subject to the limitations listed in subsections (b), (c), (d), and (e), a county board of supervisors may exempt from property tax all real property with a base year value (as determined pursuant to Chapter 1 (commencing with Section 50) of Part 0.5), and personal property with a full value so low that, if not exempt, the total taxes, special assessments, and applicable subventions on the property would amount to less than the cost of assessing and collecting them.

(b) (1) The board of supervisors shall have no authority to exempt property with a total base year value or full value of more than five thousand dollars ($5,000), except that this limitation is increased to fifty thousand dollars ($50,000) in the case of a possessory interest, for a temporary and transitory use, in a publicly owned fairground, fairground facility, convention facility, or cultural facility. For purposes of this paragraph, "publicly owned convention or cultural facility" means a publicly owned convention center, civic auditorium, theater, assembly hall, museum, or other civic building that is used primarily for staging any of the following:

(A) Conventions, trade and consumer shows, or civic and community events.

(B) Live theater, dance, or musical productions.

(C) Artistic, historic, technological, or educational exhibits.

(2) In determining the level of the exemption, the board of supervisors shall determine at what level of exemption the costs of assessing the property and collecting taxes, assessments, and subventions on the property exceeds the proceeds to be collected. The board of supervisors shall establish the exemption level uniformly for different classes of property. In making this determination, the board of supervisors may consider the total taxes, special assessments, and applicable subventions for the year of assessment only or for the year of assessment and succeeding years where cumulative revenues will not exceed the cost of assessments and collections.

(c) This section does not apply to those real or personal properties enumerated in Section 52.

(d) The exemption authorized by this section shall be adopted by the board of supervisors on or before the lien date for the fiscal year to which the exemption is to apply and may, at the option of the board of supervisors, continue in effect for succeeding fiscal years. Any revision or rescission of the exemption shall be adopted by the board of supervisors on or before the lien date for the fiscal year to which that revision or rescission is to apply.

(e) Nothing in this section shall authorize either of the following:

(1) A county board of supervisors to exempt new construction, unless the new total base year value of the property, including this new construction, is five thousand dollars ($5,000) or less.

(2) An assessor to exempt or not to enroll any property of any value, unless specifically authorized by a county board of supervisors, pursuant to this section.

480.5. Real property usage reports. (a) Every owner of tax-exempt real property shall report to the local assessor the creation, renewal, sublease, or assignment of any lease, sublease, license, use permit, or other document which conveys the right to use that real property within 60 days of the transaction. The report shall include all of the following:

(1) The name and address of the owner.

(2) The names and addresses of all other parties to the transaction, including an identification of each party and of his or her possessory interest.

(3) The type of transaction, whether creation, renewal, sublease, or assignment.

(4) A description of the property.

(5) The date of the transaction.

(6) The terms of the transaction, including all of the following:

(A) The consideration for the possessory interest, whether paid in money or otherwise.

(B) The term of the possessory interest, including any renewal or extension options.

(C) If a sublease, the original term, the remaining term, and the consideration paid for the master lease.

(D) If an assignment, the original term, the remaining term, and the consideration paid for the underlying lease.

(b) This section shall be applicable only in those counties in which the board of supervisors, by ordinance or resolution, specifically elects to have this section applicable in the county.

480.6. Change in ownership statement; possessory interest. (a) Notwithstanding any other provision of law, a holder of a possessory interest in real property that is owned by a state or local governmental entity is not required to file a preliminary change in ownership report or change in ownership statement with respect to any renewal of that possessory interest. Instead, every state or local governmental entity that is the fee owner of real property in which one or more taxable possessory interests have been created shall either file any preliminary change in ownership report or change in ownership statement otherwise required to be filed with respect to any renewal of a possessory interest, or annually file with the county assessor, no later than the 15th day of the first month following the month in which the lien date occurs, a real property usage report. The report shall include all of the following information:

(1) The name and address of the fee owner of the real property.

(2) The name and address of each holder of a possessory interest in the real property.

(3) The types of transactions in which the holders of the possessory interests acquired those interests, whether creations, renewals, subleases, or assignments.

(4) The description of the subject real property.

(5) The date of each transaction in which a holder of a possessory interest in the real property acquired that interest.

(6) The terms of each transaction described in paragraph (5), including all the following:

(A) The consideration given for the possessory interest, whether paid in money or otherwise.

(B) The terms of the possessory interest, including any renewal or extension option.

(C) For any subleases, the original term and remaining term of the sublease, and the consideration paid for the master lease.

(D) For any assignments, the original term and remaining term of the assignment, and the consideration paid for the underlying lease.

(b) The failure of a state or local governmental entity to comply with this filing requirement shall not give rise to any interest or penalties assessed against the holder of the possessory interest.

7510. Investment of assets in real property; payment of fee for general governmental services. Subsequent to the revocation of the license of a person, the board shall reinstate the permit when the person pays the amount of tax determined, together with interest and penalties, fully complies with this part, and pays a fee of fifty dollars ($50) to the board for reinstatement. The fee shall not be subject to refund except as provided in Section 8126.

Health and Safety Code

33673. Taxation of leased property. Whenever property in any redevelopment project has been redeveloped and thereafter is leased by the redevelopment agency to any person or persons or whenever the agency leases real property in any redevelopment project to any person or persons for redevelopment, the property shall be assessed and taxed in the same manner as privately owned property, and the lease or contract shall provide that the lessee shall pay taxes upon the assessed value of the entire property and not merely the assessed value of his or its leasehold interest.

33673.1. Notice of property leases. Every redevelopment agency shall provide notice to the local assessor within 30 days whenever the agency leases real property in a redevelopment project to any person or persons for redevelopment. The notice shall provide the date on which the lessee acquires the beneficial use of the leased property. The notice shall be accompanied by a memorandum of lease and a map of the leased property.

Streets and Highways Code

104.13. Department as agent for payment of possessory interest taxes due from lessees. (a) The department shall act as agent for the payment of possessory interest taxes due from persons to whom the department leases property of a type described in subdivision (e).

(b) The department shall annually provide a current list of all such property located in each county to the assessor of the county. Notwithstanding any other provision of law, the assessor shall submit the possessory interest tax bill for each property directly to the department, and the department shall be responsible for the payment of the tax in the manner described in subdivision (c).

(c) All funds distributed to a county pursuant to Section 104.10 shall be deemed to be in full or partial payment on the total possessory interest taxes due on the property described in subdivision (e) located in the county. If the amount transferred to a county pursuant to Section 104.10 in any year is less than the total possessory interest tax due on all the property located in the county, the department shall promptly forward to the county the amount of the balance due.

(d) In lieu of the information required by Section 107.6 of the Revenue and Taxation Code, all leases of property of a type described in subdivision (e) shall contain a statement that the department will pay all possessory interest taxes arising from the lease and that the amount of rent charged reflects the cost of this added responsibility of the department.

(e) This section shall apply only to real property held for future state highway needs and to real property originally held for that purpose, which the department has determined is no longer needed for that purpose, prior to its sale or exchange by the department.

APPENDIX B: PROPERTY TAX RULES

Title 18, Public Revenues
California Code of Regulations

Rule 20. TAXABLE POSSESSORY INTERESTS.

Reference: Section 107, Revenue and Taxation Code.

(A) POSSESSORY INTERESTS. "Possessory interests" are interests in real property that exist as a result of:

(1) A possession of real property that is independent, durable, and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with ownership of a fee simple or life estate in the real property in the same person; or

(2) A right to the possession of real property, or a claim to a right to the possession of real property, that is independent, durable, and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with ownership of a fee simple or life estate in the real property in the same person; or

(3) Taxable improvements on tax-exempt land.

(B) TAXABLE POSSESSORY INTERESTS. "Taxable possessory interests" are possessory interests in publicly-owned real property. Excluded from the meaning of "taxable possessory interests", however, are any possessory interests in real property located within an area to which the United States has exclusive jurisdiction concerning taxation. Such areas are commonly referred to as federal enclaves.

(C) DEFINITIONS. For purposes of this regulation:

(1) "Real property" is defined in section 104 of the Revenue and Taxation Code and includes public waters such as tidelands and navigable waters and waterways.

(2) "Possession" of real property means actual physical occupation. "Possession" requires more than incidental benefit from the public property, but requires actual physical occupation of the property pursuant to rights not granted to the general public; thus, the use of property such as hallways, common areas, and access roads at airports, stadiums, convention centers, or other public facilities by customers or employees of those who may lease other public property at the public facility of which they have exclusive use does not constitute "possession" of those hallways, common areas, or access roads by the lessee of the public property.

(3) A "right," or a "claim to a right," to the possession of real property means the right, or claim to a right, to actual physical occupation of real property. For purposes of this subdivision, a right, or a claim to a right, to the possession of real property may exist as a result of the possessor having or claiming to have: (i) a leasehold estate, an easement, a profit a prendre, or any other legal or equitable interest in real property of less than fee simple or life estate, regardless of how the interest may be identified in a deed, lease, or other document; or (ii) a use permit or agreement, such as a federal grazing permit, a permit to use a berth at a harbor, or a county use permit authorizing professional rafting outfitters to commercially operate on a river, that creates a legal or equitable interest in real property of less than fee simple or life estate.

(4) "Possessor" means the party or parties who hold the possessory interest, and any successors or assigns to such party or parties.

(5) "Independent" means a possession, or a right or claim to possession, if the possession or operation of the real property is sufficiently autonomous to constitute more than a mere agency. To be "sufficiently autonomous" to constitute more than a mere agency, the possessor must have the right and ability to exercise significant authority and control over the management or operation of the real property, separate and apart from the policies, statutes, ordinances, rules, and regulations of the public owner of the real property. For example, the control of an airport runway or taxiway by the Federal Aviation Administration (FAA) or another government agency or its agent is so complete that it precludes the airlines from exercising sufficient authority and control over the management or operation of the runways or taxiway and does not constitute sufficient "independence" to support a possessory interest.

(6) "Durable" means for a determinable period with a reasonable certainty that the possession of the real property by the possessor, or the possessor's right or claim with respect to the possession of the real property, will continue for that period.

(7) "Exclusive of rights held by others in the real property" means the enjoyment of an exclusive use of real property, or a right or claim to the enjoyment of an exclusive use together with the ability to exclude from possession by means of legal process others who may interfere with that enjoyment.

(A) For purposes of this subdivision, "exclusive uses" include the following types of uses of real property, as well as rights and claims to such types of uses of real property:

(1) The sole possession, occupancy, or use of real property,

(2) The possession, occupancy, or use of real property by co-tenants or co-owners as to leaseholds, easements, profits a prendre, or any other legal or equitable interests in real property of less than fee simple or life estate, where the uses constitute but a single use jointly enjoyed.

(3) The concurrent use of real property, not amounting to co-tenancy or co-ownership under subdivision (A)(2) above, by a person who has a primary or prevailing right to use the real property and/or to have its designees use the real property. For example, a public marina leases boat slips with a lease provision that allows the marina to rent a leased boat slip to a short-term user if the primary lessee is away; subject to the primary lessee's right to exclude the short-term user on the primary lessee's return. Under these facts, the primary lessee has a primary and prevailing right to use the leased boat slip. For purposes of this subdivision, concurrent use of real property demonstrating a primary or prevailing right also includes alternating uses of the same real property by more than one party, such as the case when certain premises are used by a professional basketball team on certain days of each week while a professional hockey team uses the same premises on certain other days.

(4) Concurrent uses of real property, not amounting to co-tenancy or co-ownership under subdivision (A)(2) above, by persons making qualitatively different uses of the real property. For purposes of this subdivision, qualitatively different uses of real property include: (i) those by persons making different kinds of uses of the same real property, such as the case when one person is developing mineral resources on real property while others are concurrently enjoying recreational uses on the same real property; and (ii) those where different persons have the right to concurrently enter onto and take different things from the same real property.

(5) Concurrent uses of real property, not amounting to co-tenancy or co-ownership under subdivision (A)(2) above, by persons engaged in qualitatively similar uses that diminish the quantity or quality of the real property. For purposes of this subdivision, uses that diminish the quantity and/or quality of the real property include: (i) grazing cattle; (ii) mining; (iii) the extraction of oil or gas; and (iv) the extraction of geothermal energy.

(6) Concurrent uses of real property, not amounting to co-tenancy or co-ownership under subdivision (A)(2) above, by persons engaged in qualitatively similar uses that do not diminish the quantity or quality of the real property, provided that the number of concurrent use grants is restricted. For purposes of this subdivision: "concurrent use grants" includes grants, permits, deeds, agreements, and other documents providing rights to the concurrent use of real property; and the number of concurrent use grants is "restricted" when the number of

concurrent use grants is restricted either by law or pursuant to the policies or management decisions of the public owner of the real property or other public agency.

Example 1: Commercial rafting outfitters have a county use permit to commercially operate on a river. While any private recreational user may raft on the river without limitation or regulation, only approximately 80 commercial rafting outfitters are presently allowed to operate under permit on the river. The commercial rafting outfitters' use of the river is exclusive for purposes of this regulation since the number of commercial use permits issued by the county to commercial rafting outfitters is restricted, regardless of whether or not the commercial rafting outfitters' use of the river diminishes its quantity or quality.

Example 2: X operates a shuttle van service, picking up passengers at their homes and other locations, and transporting them to the airport. When the shuttle van reaches the airport, it utilizes the public street which surrounds the airport to drop passengers off at the various terminals at the airport. The street around the airport is available to all licensed drivers, for commercial and noncommercial uses. Neither the traffic laws, nor the policies or management decisions of the public owner of the airport facility restrict the number of users of the public street. In addition, under the assumed facts of this hypothetical, X's use of the public street surrounding the airport does not diminish the quantity or quality of the real property.

Given that (i) the shuttle vans using the public street are making qualitatively similar uses of that real property; (ii) there are no facts indicating that the quality or quantity of the real property is being diminished; and (iii) the number of users of the real property is not restricted, X's right to use the public street surrounding the airport is not exclusive, and X does not have a possessory interest in the public street surrounding the airport.

(B) A use of real property, or a right or claim to a use of real property, that does not contain one of the elements in subdivisions (A)(1) to (6) above, inclusive, shall be rebuttably presumed to be nonexclusive.

(C) In no event shall the presence of occasional trespassers or occasional interfering uses be sufficient in and of itself to make nonexclusive a use, or a right or claim to a use, that is otherwise exclusive for purposes of this regulation.

(8) "Private benefit" means that the possessor has the opportunity to make a profit, or to use or be provided an amenity, or to pursue a private purpose in conjunction with its use of the possessory interest. The use should be of some private or economic benefit to the possessor that is not shared by the general public. The fact that a possession of real property is not for a business or commercial purpose or that the possessor is a non-profit corporation does not preclude the possessor from being found to have received a "private benefit" from that possession.

History: Adopted January 22, 1998, effective May 6, 1998.

Rule 21. TAXABLE POSSESSORY INTERESTS—VALUATION

Authority Cited: Section 15606, Government Code.
Reference: Sections 107, 107.1, Revenue and Taxation Code.

(A) DEFINITIONS. For the purposes of this regulation:

(1) "Real property" is defined in rule 20(c)(1).

(2) "Possession" is defined in rule 20(c)(2).

(3) A "right" to the possession of real property includes a "claim to a right" to the possession of real property within the meaning of rule 20(c)(3).

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(4) "Possessor" is defined in rule 20(c)(4).

(5) The "term of possession" of a taxable possessory interest means the term of possession for valuation purposes.

(6) The "stated term of possession" for a taxable possessory interest as of a specific date is the remaining period of possession as of that date as specified in the lease, agreement, deed, conveyance, permit, or other authorization or instrument that created, extended, or renewed the taxable possessory interest, including any option or options to renew or extend the specified period of possession if it is reasonable to assume that the option or options will be exercised.

(7) "Contract rent" means any compensation or payments, in cash or its equivalent, that are required to be paid or provided by a possessor under an authorization or instrument that creates a taxable possessory interest for the rights in real property provided by the taxable possessory interest.

(8) "Economic rent" means the estimated amount that would be paid by the possessor, on the valuation date in cash or its equivalent, for the rights in real property provided by the taxable possessory interest if (i) the rights to possession were offered in an open and competitive market and (ii) the public owner's interest in the property were not exempt or immune from taxation. Economic rent does not include payments by the possessor to the public owner that are not paid as consideration for rights in real property, such as payments for the rental of personal property, for the provision of security services, and for advertising and promotional services.

(9) "Creation" means the creation of a taxable possessory interest. Creation includes (i) an initial grant or other conveyance of a taxable possessory interest; (ii) a subsequent grant or other conveyance of additional land or improvements to a preexisting taxable possessory interest; or (iii) a subsequent grant or other conveyance of additional valuable property rights or uses to a preexisting taxable possessory interest.

(10) "Extension or renewal" means the lengthening of the period of possession of a taxable possessory interest, such as by the exercise of an option to extend or to renew a lease or permit.

(B) RIGHTS TO BE VALUED. Except as provided in subsection (f) or specifically provided otherwise by law, the rights to be valued in a taxable possessory interest are all rights in real property held by the possessor.

(1) The fair market value of a taxable possessory interest is not diminished by any obligation of the possessor to pay rent or to retire debt secured by the taxable possessory interest. In other words, the fair market value of a taxable possessory interest is the fair market value of the fee simple absolute interest reduced only by the value of the property rights, if any, granted by the public owner to other persons and by the value of the property rights retained by the public owner (excluding the public owner's right to receive rent).

(2) Examples of rights in real property that may be granted or retained by the public owner include the following: (i) the right to take possession of the property upon the termination of the taxable possessory interest due to the occurrence of an event such as the expiration of the contract term, a breach of agreement, or the happening of a condition that terminates the possessor's right to possession; (ii) the right to put the property to a higher and better use or otherwise restrict the possessor's use of the property; (iii) the right to terminate possession upon notice; (iv) the right to approve a sublessee or assignee; (v) the right to approve a loan secured by the taxable possessory interest; and (vi) the right to allow other possessors to use the property.

(C) STANDARD OF VALUE. Assessors shall value a taxable possessory interest consistent with the requirements of subsections (a), (d), (e), and (f) of section 110 of the Revenue and Taxation Code. A taxable possessory interest subject to article XIII A of the California Constitution shall also be valued consistent with the requirements of section 110.1 of the Revenue and Taxation Code.

(D) TERM OF POSSESSION FOR VALUATION PURPOSES.

(1) The term of possession for valuation purposes shall be the reasonably anticipated term of possession. The stated term of possession shall be deemed the reasonably anticipated term of possession unless it is demonstrated by clear and convincing evidence that the public owner and the private possessor have reached a mutual understanding or agreement, whether or not in writing, such that the reasonably anticipated term of possession is shorter or longer than the stated term of possession. If so demonstrated, the term of possession shall be the stated term of possession as modified by the terms of the mutual understanding or agreement.

(2) If there is no stated term of possession, the reasonably anticipated term of possession shall be demonstrated by the intent of the public owner and the private possessor, and by the intent of similarly situated parties, using criteria such as the following:

(A) The sale price of the subject taxable possessory interest and sales prices of comparable taxable possessory interests.

(B) The rules, policies, and customs of the public owner and of similarly situated public owners.

(C) The customs and practices of the private possessor and of similarly situated private possessors.

(D) The history of the relationship of the public owner and the private possessor and the histories of the relationships of similarly situated public owners and private possessors.

(E) The actions of the parties to the subject taxable possessory interest, including any amounts invested in improvements by the public owner or the private possessor.

(3) For the purposes of this regulation, a taxable possessory interest that runs from month to month, a taxable possessory interest without fixed term, or a taxable possessory interest of otherwise unspecified duration shall be deemed to be a taxable possessory interest with no stated term of possession.

(e) Valuation of Post-*De Luz* Taxable Possessory Interests. Except as specifically provided otherwise by law, and excluding a taxable possessory interest involving the production of gas, petroleum, or other hydrocarbons, the value of a taxable possessory interest created, extended, or renewed after December 24, 1955 (i.e., a "Post-*De Luz*" taxable possessory interest) may be estimated using one or more of the following methods, as appropriate for the taxable possessory interest being valued.

(1) COMPARATIVE SALES APPROACH TO VALUE. In the comparative sales approach, a taxable possessory interest is valued using the sale price of the subject taxable possessory interest or sales prices of comparable taxable possessory interests, provided such interests shall have sold under the conditions of fair market value described in subsection (a) of section 110. A taxable possessory interest may be valued by the direct comparison method or the indirect comparison method.

(A) Direct Comparison Method. In the direct comparison method, the appraiser shall add the following to the sale price of the subject taxable possessory interest, or to the sale price of a comparable taxable possessory interest, to derive an indicator of the fair market value of the subject taxable possessory interest: (i) the present value on the sale date of any unpaid future contract rent for the term of possession; (ii) the fair market value on the sale date of any debt assumed by the buyer of the taxable possessory interest; and (iii) the present value on the sale date of any future costs that the buyer is contractually obligated to pay for the right of possession (e.g., the cost of site restoration at the end of the term of possession) less the present value on the sale date of any future benefits in addition to the right of possession or use that the buyer is contractually entitled to receive (e.g., the salvage value of, or reimbursement value for, improvements existing at the end of the term of possession). The unpaid future contract rent in (i) above shall be reduced by any expense necessary to maintain the income from the taxable possessory interest, including any element of "gross outgo" as defined in subsection (c) of rule 8.

When valuing a taxable possessory interest by comparison with the sales of other taxable possessory interests, the other taxable possessory interests shall be located sufficiently near the subject taxable possessory interest and shall be sufficiently alike in respect to character, size, situation, usability, zoning or other enforceable government restrictions on use (unless rebutted pursuant to subdivision (c) of section 402.1 of the Revenue and Taxation Code), and restrictions on possession or use contained in the legal authorization or instrument that created extended or renewed the taxable possessory interest to make it clear that the comparable taxable possessory interests and the subject taxable possessory interest are comparable in value and that the cash equivalent price realized for the comparable taxable possessory interests may fairly be considered as shedding light on the value of the subject taxable possessory interest. The comparable sales also shall be sufficiently near in time to the valuation date of the subject taxable possessory interest. "Near in time to the valuation date" does not include any sale more than 90 days after the valuation date.

(B) Indirect Comparison Method. In the indirect comparison method, a taxable possessory interest is valued by (i) estimating the fair market value on the valuation date of the possessor's rights in real property in the taxable possessory interest as if owned in perpetuity (i.e., the value of the fee simple absolute interest in such rights) using sales of fee simple absolute interests in properties that are comparable to the subject property as prescribed in section 402.5 of the Revenue and Taxation Code and whose highest and best use corresponds to, or is comparable with, the permitted use of the subject taxable possessory interest; and (ii) reducing this value by both the present value of those property rights for the period subsequent to the term of possession (i.e., the value of the fee simple absolute interest in such rights at the end of the term of possession) and the present value of all other rights of fee simple absolute ownership, if any, that are not provided to the possessor.

(2) COST APPROACH TO VALUE. In the cost approach, a taxable possessory interest is valued by (i) adding the estimated replacement cost new less depreciation of improvements that meet the requirements of the possessor's permitted use to the estimated value of the taxable possessory interest in land; and (ii) reducing this amount by the estimated present value of the improvements that shall revert to or be retained by the public owner at the end of the term of possession.

(A) The replacement cost new less depreciation of the improvements may be estimated as prescribed in subsections (d) and (e) of rule 6. The estimated value of the taxable possessory interest in land may be estimated using the comparative sales approach (direct or indirect method) or the income approach (direct or indirect method), as prescribed in subsections (e)(1) and (e)(3).

(B) If a possessor's property use is limited to specified time periods (e.g., certain hours of the day or certain days of the week) or is shared with other possessors, the value determined by the cost approach shall be reasonably allocated to each possessor in a manner that reflects each possessor's proportionate value of the right to possession.

(3) INCOME APPROACH TO VALUE. In the income approach, a taxable possessory interest is valued by discounting the future net income that the interest in real property is capable of producing. A taxable possessory interest may be valued using the direct income method or the indirect income method.

(A) Direct Income Method. In the direct income method, a taxable possessory interest is valued by capitalizing the future net income that the taxable possessory interest is capable of producing under typical, prudent management for the term of possession.

(B) Indirect Income Method. In the indirect income method, a taxable possessory interest is valued by (i) estimating the fair market value of the possessor's rights on the valuation date as if owned in perpetuity (i.e., the value of the fee simple absolute interest in such rights) using the income approach to value as prescribed in rule 8; and (ii) reducing this value by the present value of the those rights for the period subsequent to the term of possession (i.e., the present value of the value of the fee simple interest in such rights at the end of the term of possession).

(C) Income to be Capitalized. The income to be capitalized in the valuation of a taxable possessory interest is the "net return" (as defined in subsection (c) of rule 8) attributable to the taxable possessory interest. The income to be capitalized may be based on either (i) the estimated economic rent for the subject taxable possessory interest or (ii) if the estimated economic rent is unreliable or unavailable, the estimated net operating income of a typical, prudent operator of the property subject to the taxable possessory interest. Rental income is preferable to operating income (i.e., income from operating a business) because operating income may be influenced by managerial skills and may derive, in part, from nontaxable property. The income to be capitalized must be attributable to the rights in real property in the subject taxable possessory interest and must reflect the restrictions on use inherent in the subject taxable possessory interest.

Economic rent

a. The economic rent of the subject taxable possessory interest may be estimated by reference to (i) the contract rent for the subject taxable possessory interest; (ii) contract rents for comparable taxable possessory interests; (iii) contract rents for comparable fee simple absolute interests in real property; or (iv) contract rents for other comparable interests in real property. All such contract rents shall have been negotiated in an open and competitive market involving real property reasonably comparable to the subject taxable possessory interest in terms of physical attributes, location, legally enforceable restrictions on the property's use, term of possession, and risk of cancellation of the taxable possessory interest by public owner. In addition, the contract rents shall have been negotiated sufficiently near in time to the valuation date as to shed light on the economic rent of the subject taxable possessory interest.

b. When using the contract rent of a taxable possessory interest as an indicator of the economic rent, the assessor shall add to the contract rent (i) an estimate of the amount, if any, by which the contract rent has been reduced because improvements have been constructed at the possessor's expense that will revert to the public owner at the end of the term of possession; and (ii) an estimate of the amount, if any, by which the contract rent has been reduced because the possessor will bear the cost of restoring the real property to its original condition on reversion to the public owner, including the cost of removing improvements (less any estimated salvage value of, or reimbursement value for, the improvements), or the cost of any similar obligation.

c. To arrive at the income to be capitalized, any expense necessary to maintain the income from the subject taxable possessory interest, including any element of "gross outgo" as defined in subsection (c) of rule 8, whether paid by the public owner or the possessor, must be deducted from the estimated economic rent if the expense will be paid out of the estimated economic rent.

Net Operating Income

a. Net operating income is gross operating income less allowed expenses. Gross operating income, allowed expenses, and net operating income are defined herein consistent with "gross return," "gross outgo," and "net return," respectively, in subsection (c) of rule 8.

b. When valuing a taxable possessory interest using operating income, allowed expenses include the following: cost of goods sold (if applicable), typical operating expenses, typical management expense, an allowance for a return on working capital, and an allowance for a return on the value of any nontaxable property that contributes to the gross operating income. Typical operating expenses may include expenses for the rental of personal property, for the provision of security services, and for advertising and promotional services, provided such expenses are necessary for the production of the gross income. Typical operating expenses and typical management expense include expenses that an owner/operator typically would bear to maintain the property and to continue the production of income from the property but are borne by the public owner in the case of the subject taxable possessory interest.

c. Allowed expenses do not include the following: amortization, depreciation, depletion charges, debt retirement, interest on funds invested in the taxable possessory interest, the contract rent for the taxable possessory interest, property taxes on the taxable possessory interest, income taxes, or state franchise taxes measured by income.

(D) Capitalization Rate. Subsection (g) of rule 8 provides that a capitalization rate may be developed by either comparing the anticipated net incomes of recently sold comparable properties with their sales prices, or by deriving a weighted average of the capitalization rates (rates of return) for debt and equity capital appropriate to California money markets. In accordance with rule 8, the capitalization rate used in the valuation of a taxable possessory interest may be developed by (i) comparing the anticipated net incomes from comparable taxable possessory interests with their sales prices stated in cash or its equivalent and adjusted as described in subsection (e)(1)(A); (ii) comparing the anticipated net incomes of comparable fee simple absolute interests in real property with their sales prices stated in cash or its equivalent, provided the comparable fee properties are not expected to produce significantly higher net incomes subsequent to the subject taxable possessory interest's term of possession than during it; or (iii) by deriving a weighted average of the capitalization rates for debt and equity capital appropriate for the subject taxable possessory interest, weighting the separate rates of debt and equity by the relative amounts of debt and equity capital expected to be used by a typical purchaser of the subject taxable possessory interest. Consistent with subsection (f) of rule 8, the capitalization rate shall contain a component for property taxes where applicable.

(F) VALUATION OF PRE-*DE LUZ* TAXABLE POSSESSORY INTERESTS. Except as specifically provided otherwise by law, and excluding a taxable possessory interest involving the production of gas, petroleum, or other hydrocarbons, the value of a taxable possessory interest created prior to December 24, 1955, and not since renewed or extended (i.e., a "Pre-*De Luz*" taxable possessory interest) is the excess of the fair market value on the valuation date of the taxable possessory interest over the present value of unpaid future contract rent for the unexpired term of possession (i.e., for the term of possession). This value may be estimated using one or more of the following methods, as appropriate for the taxable possessory interest being valued.

(1) COMPARATIVE SALES APPROACH TO VALUE. A Pre-*De Luz* taxable possessory interest may be valued by the comparative sales approach using the direct comparison method or the indirect comparison method, as described in subsection (e)(1), but with the following modifications:

(A) Direct Comparison Method. In the direct comparison method, the present value of the unpaid future contract rent is not added to the sale price of the taxable possessory interest.

(B) Indirect Comparison Method. In the indirect comparison method, the value of the possessor's rights as if owned in fee is reduced by the present value of the unpaid future contract rent of the taxable possessory interest, as well as by the value of those property rights for the period subsequent to the term of possession.

(2) COST APPROACH TO VALUE. A Pre-*De Luz* taxable possessory interest may be valued by the cost approach as described in subsection (e)(2), but the present value of any unpaid future contract rent of the taxable possessory interest in land for the term of possession is also deducted.

(3) INCOME APPROACH TO VALUE. A Pre-*De Luz* taxable possessory interest may be valued by the income approach using the direct income method or the indirect income method, as described in subsection (e)(3), but with the following modifications:

(A) Direct Income Method. In the direct income method, the net income to be capitalized is reduced by the unpaid future contract rent for the term of possession, as well as by allowed expenses.

(B) Indirect Income Method. In the indirect income method, the present value of the unpaid future contract rent for the term of possession is deducted from the value of the fee interest, as well as the deduction of the present value of the property rights for the period subsequent to the term of possession.

History: Adopted January 6, 1971, effective February 18, 1971.

Amended December 17, 1975, effective January 25, 1976.
Amended January 22, 1998, effective May 6, 1998.
Amended March 27, 2002, effective July 11, 2002.

Rule 22. CONTINUITY OF POSSESSORY INTERESTS.

Reference: Sections 107, 107.1, 107.4, Revenue and Taxation Code.

(a) The continuity of possession or exclusive use necessary to establish a possessory interest will vary according to the location and character of the property. The continuity of use necessary for finding a possessory interest to exist is satisfied when the possessor of the property uses it to substantially the same extent as would an owner engaged in the same activity.

(b) Standards for determining the existence of taxable possessory interests based on continuity are:

(1) Actual or constructive possession or exclusive use of property on the lien date for the current year.

(2) Recurrent possession or exclusive use, whether or not the period extends through the lien date, when there is a history on the lien date of recurring use by the present or former possessors making a similar use of the property.

(3) Infrequent actual possession or exclusive use on a recurrent basis when the continuation of the right to possession or exclusive use is conditioned on or evidenced by the possessor having made a contribution to the value of the property by way of investment on or near the property occupied.

History: Adopted January 6, 1971, effective February 18, 1971.

RULE 27. VALUATION OF POSSESSORY INTERESTS FOR THE PRODUCTION OF HYDROCARBONS.

Reference: Sections 107, 107.2, 107.3, Revenue and Taxation Code.

(a) The taxable value of all possessory interest for the production of gas, petroleum, and other hydrocarbon substances from beneath the surface of the earth shall be determined by application of the comparative sales or income approach in the manner prescribed in subsection (a) or (b) of section 25 except as provided in subsection (b) of this section.

(b) The taxable value of a possessory interest for the production of hydrocarbon substances from beneath the surface of the earth shall be determined by application of the comparative sales or income approach in the manner prescribed in subsection (a) or (b) of section 26 if:

(1) the interest was created or last extended or renewed on or before July 26, 1963, and the rate of royalties or other right to share in production was not reduced because of an increase in the assessed value of such interest or

(2) the interest was created on or before July 26, 1963, and has been extended or renewed thereafter pursuant to authority which prohibits reduction of the rate of royalty or other right to share in production because of an increase in the assessed value of such interest.

History: Adopted January 6, 1971, effective February 18, 1971.

Rule 28. EXAMPLES OF TAXABLE POSSESSORY INTERESTS.

Reference: Sections 107, 107.1, 107.2, 107.3, 107.4, Revenue and Taxation Code.

The following are examples of commonly encountered taxable possessory interests:

(a) The right to explore for, capture, and reduce to possession gas, petroleum, and other hydrocarbons in public lands.

(b) The possession of an employee in housing owned by a public agency, irrespective of whether occupancy of the housing is a condition of employment except when the facility also serves as the employee's work area to which the employer has full access.

(c) The right to cut and remove standing timber on public lands.

(d) The right to graze livestock or raise forage on public lands.

(e) The possession of public property at harbors, factories, airports, golf courses, marinas, recreation areas, parks, and stadiums. Possessory interests may include land subject to the ultimate grant of a United States patent, commercial and industrial sites, and water rights.

History: Adopted January 6, 1971, effective February 18, 1971.

Rule 29. TAXABLE POSSESSORY INTEREST LIMITATION AMOUNT.

Authority Cited: Section 15606(c), Government Code.
Reference: Article XIII, section 11, California Constitution.

(A) DEFINITIONS. For purposes of this rule:

(1) "Assessed value" is defined in subdivision (a) of section 135 of the Revenue and Taxation Code.

(2) "Improvements" are defined in rule 122.

(3) "Land" is defined in rule 121.

(4) A "lease for agricultural purposes" is a lease for the purpose of the production or husbandry of plants or animals, including gardening, horticulture, fruit growing, and the storage and marketing of agricultural products.

(5) "Other taxable improvements" are improvements owned by a local government outside of its boundaries that are taxable for property tax purposes pursuant to section 11(a), excluding taxable replacement improvements.

(6) "Real property" is the appraisal unit of real property, as defined in section 104 of the Revenue and Taxation Code, that persons in the marketplace commonly buy and sell as a unit or that is normally valued separately.

(7) "Section 11" means section 11 of Article XIII of the California Constitution.

(8) The "section 11 taxable possessory interest limitation amount" means the fair market value of the taxable government-owned real property on the lien date less the section 11 value of the taxable government-owned real property on the lien date.

(9) The "section 11 value of taxable government-owned real property" means the sum of: (i) the section 11 assessment amount for the taxable lands included in the real property on the lien date, computed pursuant to subdivisions (b) and (c) of section 11; (ii) the section 11 assessment amount for any taxable replacement improvements included in the real property on the lien date computed pursuant to the provisions of subdivision (d)

of section 11; and (iii) the fair market value of other taxable improvements included in the real property on the lien date, if any.

(10) "Taxable government-owned real property" is real property owned by a local government outside of its boundaries that is taxable for property tax purposes pursuant to section 11(a).

(11) "Taxable lands" are lands owned by a local government outside of its boundaries that are taxable for property tax purposes pursuant to section 11(a).

(12) "Taxable possessory interest" is defined in rule 20.

(13) "Taxable replacement improvements" are improvements owned by a local government outside of its boundaries that are taxable for property tax purposes pursuant to section 11(a) because they were constructed by the local government to replace improvements that were taxable when acquired.

(14) The "total assessed value of all taxable possessory interests" means the aggregate assessed values of all taxable possessory interests in an appraisal unit of taxable government-owned real property on the lien date.

(B) TAXABLE POSSESSORY INTERESTS IN TAXABLE GOVERNMENT-OWNED REAL PROPERTY. Except as set forth below in subsection (c) of this regulation, taxable possessory interests in taxable government-owned real property, excluding those created as a result of the possessor having a lease for agricultural purposes, shall be assessed and taxed for purposes of property taxation in the same manner as other taxable possessory interests.

(C) LIMITATION ON THE ASSESSMENT OF TAXABLE POSSESSORY INTERESTS IN TAXABLE GOVERNMENT-OWNED REAL PROPERTY. On each lien date, the total assessed value of all taxable possessory interests in an appraisal unit of taxable government-owned real property shall be determined. If the total assessed value of all taxable possessory interests on the lien date exceeds the section 11 taxable possessory interest limitation amount on the lien date, then the assessed values of the taxable possessory interests shall be reduced as follows: (i) if there is only one taxable possessory interest in the appraisal unit of taxable government-owned real property on the lien date, then the assessed value of that taxable possessory interest shall be reduced so that it does not exceed the section 11 taxable possessory interest limitation amount; or (ii) if there is more than one taxable possessory interest in the appraisal unit of taxable government-owned real property on the lien date, then the assessed value of each such taxable possessory interest shall be ratably reduced in the proportion that it bears to the total assessed value of all taxable possessory interests until the total assessed value of all taxable possessory interests no longer exceeds the section 11 taxable possessory interest limitation amount.

History: Adopted October 24, 2001, effective February 9, 2002.

APPENDIX C: SUMMARY OF COURT CASES

Significant cases relating to taxable possessory interests:

Agua Caliente Band of Mission Indians v. Riverside County (1971) 442 F.2d 1184, cert. denied 405 U.S. 933. A federal court refused to enjoin the imposition of a tax on the possessory interest held by lessees of Indian land holding that the tax was on the lessee's interest in the land and not on the Indians' land. The mere fact that the tax increased the financial burden on the Indians in the form of reduced rents did not vitiate the tax.

American Airlines, Inc. v. County of Los Angeles (1976) 65 Cal.App.3d 325. The court invalidated an assessment based on a valuation method that used a reasonably anticipated term of possession in excess of the remaining lease term plus option periods.

Bakersfield & Fresno Oil Co. v. Kern County (1904) 144 Cal. 148. The possessory right to a mining claim subject to a lease is taxable as a possessory interest.

Blinn Lumber Company v. County of Los Angeles (1932) 216 Cal. 148. The court allowed a deduction for rent paid by lessee when estimating the income to be capitalized for a taxable possessory interest. The deduction for rent was subsequently reversed in *De Luz Homes, Inc. v. San Diego County*.

Board of Supervisors v. Archer (1971) 18 Cal.App.3d 717. The court upheld assessment of taxable possessory interests in federal lands based on grazing permits and leases.

City and County of San Francisco v. County of San Mateo (1995) 10 Cal.4th 554. Base year value concept of Californian Constitution, article XIII A, applies to real property assessed under California Constitution, article XIII, section 11.

City of Desert Hot Springs v. Riverside County (1979) 91 Cal.App.3d 441. A possessory interest acquired by a contractor under a lease from a city was retained upon the leaseback of the property to the city. Possession by the city under the sublease was not in opposition to but pursuant to and subordinate to the contractor's right.

City of San Jose v. Carlson (1997) 57 Cal.App.4th 1348. Short-term users of a city's facilities obtained taxable possessory interests in the facilities when they obtained use permits on more than one occasion. Two-time uses of the facilities meet the criteria of durability, independence, and exclusivity necessary to constitute possessory interests. And the agreement between the city and the users accorded sufficient control to the users to meet the criterion of independent possession.

Connolly v. Orange County (1992) 1 Cal.4th 1105. Possessory interests taxable under this section include privately held possessory interests in property owned by the federal, state, or municipal government, since the use is private rather than public. However, the governmental entity does not lose its tax exemption by leasing its land. The reversion is not taxed, for it is only the value of the use for the unexpired term of the lease that is assessed. This rule applies to property owned by public schools and colleges.

Cox Cable San Diego, Inc. v. San Diego County (1986) 185 Cal.App.3d 368. The interests of a cable television distribution company in franchise agreements granting the company the right to use and occupy public rights of way for the purpose of distributing its service are property subject to property taxation since the company's use of the public rights of way constitutes a taxable possessory interest. A possessory interest may be the interest of either an easement holder or a mere permittee or licensee.

County of Los Angeles v. County of Los Angeles AAB No. 1 (1993) 13 Cal.App.4th 102. 'Taxable possessory interests in public property are grounded on physical possession or use of it; not just some benefit from public property.

De Luz Homes, Inc. v. San Diego County (1955) 45 Cal.2d 546. Taxable possessory interests must be valued at full cash value, like all other real property, without deductions for leasehold costs.

Douglas Aircraft Co. v. Byram (1943) 57 Cal.App.2d 311. Absent specific statutory authorization, a taxable possessory interest cannot exist in personal property.

Dressler v. Alpine County (1976) 64 Cal.App.3d 557. The recurrent character of federal grazing permits issued subsequent to the tax lien date supports the existence of a taxable possessory interest.

El Tejon Cattle Co. v. San Diego County (1966) 64 Cal.2d 428. In assessing the possessory interest of a lessee of tax-exempt land leased for grazing purposes, it is proper to capitalize the rent for the total number of years of the lease and renewal options. Natural grasses on the land, which do not require annual or seasonal planting, are not exempt from taxation as growing crops.

English v. County of Alameda (1977) 70 Cal.App.3d 226. An occupation of a hospital- or university-owned residence by a physician or professor is exempt under the welfare or college exemption if incidental to, or reasonably necessary for, the accomplishment of the exempt purpose.

Euro-Pacific v. Alameda County (1992) 11 Cal.App.4th 891. Vessel owner's contractual right to use publicly owned maritime facilities may be a possessory interest in real property that is subject to taxation, even though the right is concurrent with the rights of others and subject to restrictions on right of use. Exclusive use is not destroyed by concurrent use when the extent of each party's use is limited by the other party's right to use the property at the same time. Possible interference with use affects value, but not the existence of a possessory right.

Forster Shipbldg. Co. v. Los Angeles County (1960) 54 Cal.2d 450. Leasehold interests in tax-exempt land are not personal property within the meaning of Section 14 of Article XIII of the State Constitution and that portion of the above section which declares such leasehold interests to be personal property is invalid; however, the remaining provisions of the above section are valid.

Fort Mojave Tribe v. San Bernardino County (1976) 543 F.2d 1253, cert. den. 430 U.S. 983. The imposition of a taxable possessory interest on non-Indian lessees of reservation land is not violative of the Indian Reorganization Act. Upheld the assessment of a taxable possessory interest in land held in federal trust for reservation Indians but leased to a non-Indian.

Freeman v. Fresno County (1981) 126 Cal.App.3d 459. The owner of amusement machines placed for private profit in public facilities, including an airport terminal, meets the requirement of exclusiveness, and is therefore subject to a taxable possessory interest. Despite the small size and variable location of the space occupied by each machine, the owner had a special right of access for profit not shared in common by all who entered such facilities, and such space was not by its size or movement made unvaluable to the owner.

General Dynamics Corp. v. Los Angeles County (1958) 51 Cal.2d 59. The legislature has not defined personal property as including a right to its possession as it has real property.

Georgia-Pacific Corporation v. Mendocino County; *International Paper Company v. Siskiyou County* (1972) 340 F.Supp. 1061; 357 F.Supp. 380; 515 F.2d 285. The interest of timber operators created by a contract with the U.S. Forest Service whereby the timber operators obtain a present right in the standing timber and the right to go upon the federal land to harvest the timber constitutes a taxable possessory interest. There is no rule under California law that a vendee under a land sale has no taxable interest until the sale is completed.

G. G. Moore & Co. Engineers v. Quinn (1957) 149 Cal.App.2d 666. There is no taxable property interest in unassembled boiler parts held by contractors because legal title or beneficial ownership was held by the exempt public agencies.

Hammond Lumber Co. v. City of Los Angeles (1936) 12 Cal.App.2d 277. A leasehold estate carries a right to the possession of land, and therefore constitutes real property for purposes of taxation. Although ordinarily a leasehold is taxed to the owner of the reversionary interest, the value of the lessee's estate being treated as a constituent part of the valuation of the freehold, where the reversion is publicly owned and therefore tax exempt, a separate assessment of the leasehold to the lessee may be had.

John Tennant Memorial Homes, Inc. v. City of Pacific Grove (1972) 27 Cal.App.3d 372. Although not a basis for its decision in the case, a court indicated that the interest of an occupant in a retirement home exempt from property taxation pursuant to Revenue and Taxation Code section 214 did not constitute a taxable possessory interest in the tax exempt premises since the occupants were using the property for a non-taxable purpose.

Kaiser Co., Inc. v. Reid (1947) 30 Cal.2d 610. A shipbuilding corporation having a right under contracts with the United States Maritime Commission to the exclusive use and possession as an independent contractor, of the land and facilities of a shipyard owned by the United States and the shipbuilding facilities owned by the United States in another shipyard is a lessee of the property and its possessory interest therein is taxable.

Lucas v. County of Monterey (1977) 65 Cal.App.3d 947. Upheld the assessment of a taxable possessory interest in a private berthing in a public harbor.

Mann v. County of Alameda (1978) 85 Cal.App.3d 505. There is no taxable possessory interest held by students who reside in University of California family housing.

Mattson v. Contra Costa County (1968) 258 Cal.App.2d 205. An operator of a restaurant at a municipal golf course was held to have a taxable interest where his possession was marked by independence, durability and exclusiveness even though the basis of his rights was a contract rather than a lease.

McCaslin v. DeCamp (1967) 248 Cal.App.2d 13. The exclusive right to the use of a house furnished by a tax exempt irrigation district to its employee on a month-to-month basis was a taxable possessory interest even though the right was terminable with the termination of employment.

Metropolitan Stevedore Co. v. Los Angeles County (1972) 29 Cal.App.3d 565. Plaintiff, holder of a preferential assignment in city harbor property, contended that assessment of the assignment (a possessory interest) was discriminatory because similar interests of others had not been assessed. Court held there was no discrimination; the other interests were different, some assessments had not been made pending outcome of plaintiff's suit, and, in general, discrepancies arising from assessor's mistake or lack of information which result in some assessments not being made are not grounds for declaring all other assessments invalid.

Orange County v. Orange County Assessment Appeals Board No. 1 (1993) 13 Cal.App.4th 524. County assessment appeals board did not err in separating cable television system's property into land and land improvements, fixtures, and personal property rather than considering all the property as one appraisal unit for valuation purposes. Section 51 does not mandate appraisal of the property as a single unit. To the contrary, applicable law suggests that rationally dividing property into component parts for valuation purposes is proper. County assessment appeals board did not err in rejecting the comparable sales approach and the income approach when valuing taxable tangible property of a cable television system. The selection of a particular method is within the board's discretion and is constrained only by fairness and uniformity. Thus, use of the income capitalization method using the annual franchise rent was appropriate for valuing the taxpayer's possessory interest, and use of the cost replacement method was appropriate for valuing the remainder of the property, where the board found that neither the comparable sales approach nor the income approach was a reliable method for the property.

Pacific Grove-Asilomar Operating Corp. v. Monterey County (1974) 43 Cal.App.3d 675. A nonprofit corporation organized for the purpose of managing exempt, state-owned property does not acquire a taxable possessory interest in the property where a principal-agent relationship exists, where the corporation is under state control and holds the property for the public benefit, and where possession by the corporation is not so exclusive as to amount to such an interest. In determining whether a possessory interest is taxable, the factors of exclusiveness, independence, durability and private benefit are weighted on a case-by-case basis.

Palm Springs Spa, Inc. v. Riverside County (1971) 18 Cal.App.3d 372. The imposition of a nondiscriminatory tax on the possessory interest of a lessee in Indian land held in trust by the federal government did not impose an undue burden on commerce with the Indians in violation of the federal Constitution, nor was it a tax directly on federal property.

People v. Donnelly (1881) 58 Cal. 144. The possessory interest of an occupant or claimant of public lands of the State or of the United States is taxable, although no part of the purchase price has been paid.

People v. Shearer (1866) 30 Cal. 645. Privately held interests in otherwise exempt real property are subject to the constitutional command that all property be taxed.

Rand Corp. v. Los Angeles County (1966) 241 Cal.App.2d 585. The right of a nonprofit corporation to use government property permanently affixed to the realty is exclusive and, hence, a taxable possessory interest. Although such right is pursuant to a yearly contract, the corporation pays no rent and cannot transfer its right without consent and the government can cancel the contract and remove the property. Since possessory interests in improvements to real property are defined as real property in sections 104 and 105 of the Revenue and Taxation Code, they are taxable as such under Cal. Const. Art. XIII, Sec. 1, although no specific statute imposes a tax on possessory interests. A provision in a contract pursuant to a government regulation that property does not lose its identity as personalty by reason of affixation to the realty does not preclude the state from classifying government property as improvements to real property for taxation purposes." The fact that the holder of a taxable possessory interest is a nonprofit corporation does not necessarily mean that the possession confers no private benefit to the holder.

Russ Building Partnership v. City and County of San Francisco (1988) 199 Cal.App.3d 1496. Double taxation only occurs when two taxes of the same character are imposed on the same property by the same taxing authority within the same jurisdiction during the same time period.

Riverside County v. Palm-Ramon Development Co. (1965) 63 Cal.2d 534. In using the income method to value a taxable possessory interest, it is the net earnings that would be anticipated by a prospective purchaser that are to be capitalized.

San Bernardino County v. Harsh California Corp. (1959) 52 Cal.2d 341. In an action brought by a county to collect unsecured property taxes levied against a leasehold in land leased by the United States to defendant for construction of family dwelling units for military and civilian personnel under a federal statute consenting to local taxation with a deduction therefrom for payments made by the United States in lieu of taxes, although the outcome would not directly affect the pecuniary interest of the United States, the government may intervene because it does have an interest in sustaining its fiscal policy.

San Pedro, etc. R. R. Co. v. City of Los Angeles (1919) 180 Cal. 18. A leasehold estate carries a right to the possession of land, and therefore constitutes real property for purposes of taxation. Although ordinarily a leasehold is taxed to the owner of the reversionary interest, the value of the lessee's estate being treated as a constituent part of the valuation of the freehold, where the reversion is publicly owned and therefore tax exempt, a separate assessment of the leasehold to the lessee may be had.

Scott-Free River Expeditions, Inc. v. El Dorado County (1988) 203 Cal.App.3d 896. The exclusive and profitable use of public property for commercial rafting by a commercial rafting company constitutes a taxable possessory interest. The tax is on the company's use of the water, and the right to use water is a valuable property right upon which a possessory interest tax may be levied.

Sea-Land Service, Inc. v. Alameda County (1974) 36 Cal.App.3d 837. A shipping company using a city's marine terminals under a "Preferential Assignment Agreement" had a taxable possessory interest where the agreement gave the company exclusive possession against all the world, including the city, whenever it had a "business need" for the premises, where the company had continuously used and had a business need to use all of the premises, and where analysis of the entire agreement established that it was comparable to a lease.

Seatrain Terminals of California, Inc. v. Alameda County (1978) 83 Cal.App.3d 69. Exclusive use of two 750 ton cargo cranes, mounted on rails specially installed on the wharf, constitutes a taxable possessory interest. The cranes were properly classified as fixtures since they were intended to be a permanent part of the wharf.

Service America Corporation v. San Diego County (1993) 15 Cal.App.4th 1232. A stadium food and beverage concessionaire is subject to a taxable possessory interest, the value of which does not include enterprise value as distinguished from the value of its use of the property under agreement with the stadium owner.

Shubat v. Sutter County Assessment Appeals Board (1993) 13 Cal.App.4th 794. The interests of a cable television distribution company in franchise agreements granting the company the right to use and occupy public rights of way for the purpose of distributing its service are property subject to property taxation since the company's use of the public rights of way constitutes a taxable possessory interest. A possessory interest may be the interest of either an easement holder or a mere permittee or licensee." A county assessment appeals board erred in ruling that a cable television company's entire franchises, which consist of two components, the right to use public streets to lay cables and the right to charge a fee to subscribers for their use of cable facilities, were nontaxable intangibles. Both the California Constitution and statutes mandate that all property must be taxed if not exempt under federal or state law, and under applicable case law the right to use public rights-of-way is an assessable possessory interest in real property.

Slade v. Butte County (1910) 14 Cal.App. 453. A holder of a certificate of purchase of lieu lands who has never been in possession or claimed the right of possession is not taxable thereon. The term "claim to land" contemplates an actual possession of the land claimed.

Specialty Restaurants Corporation v. Los Angeles County (1980) 111 Cal.App.3d 607. Possessory interests in improvements to real property are dependent for existence on real property, which in the case of a vessel can include areas aboard the vessel, the real property upon which the vessel lies, and parking areas, and an assessment of taxable possessory interests must necessarily include the value of the supporting land.

Stadium Concessions, Inc. v. City of Los Angeles (1976) 60 Cal.App.3d 215. A coliseum and sports arena food and beverage concessionaire meets the requirement of exclusiveness and is therefore subject to a taxable possessory interest. Under property tax Rule 21(e)(2) the interest of the concessionaire qualifies as a concurrent use.

Stanislaus County v. Assessment Appeals Board (1989) 213 Cal.App.3d 1445. A county assessment appeals board erred in ruling that a cable television company's entire franchises, which consist of two components, the right to use public streets to lay cables and the right to charge a fee to subscribers for their use of cable facilities, were nontaxable intangibles. Both the California Constitution and statutes mandate that all property must be taxed if not exempt under federal or state law, and under applicable case law the right to use public rights-of-way is an assessable possessory interest in real property.

State v *Moore* (1859) 12 Cal. 56. A private individual's possession of public lands for mining purposes is a taxable property interest.

Stanislaus County v. Assessment Appeals Board (1989) 213 Cal.App.3d 1445. This section [Revenue and Taxation Code section 107.7], which codified case law holding that a cable television company's rights-of-way under the authority granted by public entities constitute an assessable franchise subject to property tax, was inapplicable to assessments for the 1982–83 through 1985–86 fiscal years since the county's right to the taxes at issue became fixed on the lien dates of the fiscal years to which they related, which dates preceded enactment of the section.

Tilden v. Orange County (1949) 89 Cal.App.2d 586. A separate assessment of the possessory interest in leased public lands to a sublessee in possession is valid.

United Air Lines, Inc. v. San Diego County (1991) 1 Cal.App.4th 418. The purpose of this section [Revenue and Taxation Code section 107] is to protect the public domain from private profit without tax liability. And use by commercial air passenger carriers of an international airport was business use and sufficiently exclusive as to qualify as a taxable possessory interest, even though the general aviation public had concurrent landing rights.

United States v. Fresno County (1975) 50 Cal.App.3d 633. Occupancy of dwelling units in national forests by U.S. Forest Service employees, which consisted of nontransferable rights of possession, terminable at the will of the federal government, together with other restrictions, results in a taxable possessory interest, the value of which must be subject to the restrictive factors. The assessment is not made against the federal government but against the usufructuary interest of the employees in the units.

United States v. Humboldt County (1980) 628 F.2d 549. Occupancy of dwelling units on base and off base by military personnel, being neither durable nor private, does not result in a taxable possessory interest. Even if it did result in a possessory interest, any resultant tax imposed would be constitutionally impermissible as a tax imposed upon federal functions and properties.

United States v. San Diego County (1995) 53 F.3d 965. Exclusive, independent, and durable interest in experimental fusion device owned by the United States constitutes a taxable possessory interest. The device was properly classified as a fixture where it weighed more than 400 tons, it was annexed to the underlying land by gravity, and the land had been modified to accommodate it. It is not unconstitutional for a county to calculate the value of a taxpayer's possessory interest in an experimental fusion device by using the value of the device.

United States v. San Diego County (1992) 965 F.2d 691. A federal contractor had a possessory interest in a government-owned experimental fusion devise, which was properly classified as an improvement, and was not immune from ad valorem taxation under the supremacy clause of the United States Constitution. A federal contractor's possessory interest in experimental fusion device owned by the United States sufficiently distinguished contractor from the government, so that tax imposed on contractor was not tax on United States in violation of Supremacy Clause.

Wells National Services Corporation v. Santa Clara County (1976) 54 Cal.App.3d 579. The provision of television receivers for rental to patients at a county hospital except for two wards equipped with the hospital's own sets constitutes a taxable possessory interest. The test is not exclusive possession against all the world, including the owner. If the right of possession must be shared to some extent, it is to be considered in fixing the value but does not destroy the existence of the possessory interest.

Wrather Port Properties, Ltd. v. County of Los Angeles (1989) 209 Cal.App.3d 517. An extension of a lease term from 40 years to 66 years was not a change in ownership for purpose of this section [Revenue and Taxation Code section 61] where the extension was automatic under a provision of the original lease whereby the parties intended to create a possessory interest for the maximum term allowed by the city's charter; where at the time the lease was signed, a charter amendment increasing the permissible term was on the ballot for an election less than a month away; and where the assessor recognized and based his first valuation of the lease on the longer term.

GLOSSARY

Term	Definition
Ad valorem	Latin phrase meaning "in proportion to the value". In California, the property tax is considered to be an ad valorem tax.
Amortization	The process of retiring a debt or recovering a capital investment through scheduled, systematic repayment of principal; a program of periodic contributions to a sinking fund or debt retirement fund.
Animal unit month	The quantity of feed that a mature l,000 pound cow or five mature sheep need for one month to sustain life and maintain good health.
Annuity	A periodic series of obligatory payments; an annuity can be level, increasing, decreasing, or a combination thereof.
Annuity factor	In yield capitalization, the number, usually obtained from financial tables, that is multiplied by an income amount to produce an estimate of present value.
Appraisal unit	That property which persons in the marketplace normally buy and sell as a unit or which is normally valued separately.
Appreciation	The increase in property value resulting from an excess of demand for a property relative to its supply.
Assessed value	The taxable value of a property against which the tax rate is applied.
Assessee	Person who owns, claims, possesses, or controls the property on the lien date.
Assessment roll	A listing of all taxable property within a county. It identifies, at a minimum: (1) the property (usually by assessor's parcel number); (2) the tax-rate area where the property is located; (3) the name (if known) and mailing address of the assessee; (4) the assessed value of the property, including separate assessed values for land, improvements, and personal property; (5) penalties (if any); and (6) the amount (if any) of specified exemptions (e.g., Homeowners', Church, Welfare, etc.). Distinct assessment rolls include the locally-assessed secured and unsecured regular assessment rolls, the locally-assessed supplemental assessment roll, and the state-assessed roll (which is added to the locally-assessed secured roll).

Term	Definition
Band of investment	A technique in which the capitalization rates attributable to components of a capital investment are weighted and combined to derive a weighted-average rate attributable to the total investment.
Base year value	In accordance with section 110.1, a property's base year value is its fair market value as of either the 1975 lien date or the date the property was last purchased, newly constructed, or underwent a change in ownership after the 1975 lien date.
Capitalization	Any method of converting expected future benefits into an indicator of present value; the discounting of projected income to a present value.
Capitalization rate	Any rate used to convert income into an indicator of value; a ratio that expresses a relationship between income and value.
Change in ownership	A transfer of a present interest in property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.
Comparative sales approach	An approach to value by reference to sale prices of the subject property or comparable properties; under Rule 4, the preferred approach when reliable market data are available.
Contract rent	The actual amount of rent a property is earning as specified in a lease; the existing rent on property as distinguished from rent that could be expected if the property were available for rent on the open market.
Cost approach	A value approach using the following procedures to derive a value indicator: (1) estimate the current cost to reproduce or replace an existing structure without untimely delays; (2) deduct for all accrued depreciation; and (3) add the estimated land value and an amount to compensate for entrepreneurial profit (if present).
Depreciation	A decrease in utility resulting in a loss in property value; the difference between estimated replacement or reproduction cost new as of a given date and market value as of the same date. There are three principal categories of depreciation: physical deterioration, functional obsolescence, and external obsolescence.

Term	Definition
Direct capitalization	A capitalization method used to convert a single year's income expectancy into an indicator of value, either by dividing the income estimate by an appropriate rate or by multiplying the income estimate by an appropriate factor.
Discount rate	A selected yield rate used to convert expected future payments into an estimate of present value.
Discounted cash flow method	A capitalization method in which a discount rate is applied to a series of projected income payments, including the reversion, in order to arrive at an estimate of present value (i.e., current market value). The DCF method can be applied with any yield capitalization technique.
Economic life	The period of time over which improvements to real property contribute to property value.
Economic Rent	The amount of rental income that could be expected from a property if available for rent on the open market, as indicated by the prevailing rental rates for comparable properties under similar terms and conditions; economic rent is distinguished from contract rent, which is the actual rental income for the subject property as specified in a lease; economic rent is also referred to as market rent.
Equity yield rate	An annualized rate of return on equity capital, as distinguished from the rate of return on debt capital or interest; the equity investor's internal rate of return.
Fair market value	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 with knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions upon those uses and purposes.
Fee simple estate	Absolute ownership unencumbered by any other interest or estate, subject only to the limitations of eminent domain, escheat, police power, and taxation.

Term	Definition
Fixture	An item of tangible property, the nature of which was originally personal property, but which is classified as real property for assessment purposes because it is physically or constructively annexed to real property with the intent that it remain annexed indefinitely.
Full cash value	See *fair market value*.
Full economic cost	Cost for appraisal purposes. Includes all market costs (direct and indirect) necessary to purchase or construct equipment and make it ready for its intended use.
Gross outgo	Any outlay of money or money's worth, including current expenses and capital expenditures required to develop and maintain the estimated income.
Gross return	Any money or money's worth which the property will yield over and above vacancy and collection losses, including ordinary income, return of capital, and the total proceeds from sales of all or part of the property.
Highest and best use	The most profitable use of a property at the time of the appraisal; that available use and program of future utilization that produces the highest present land value; must be legal, physically possible, financially feasible, and maximally profitable; see text for the distinction between highest and best use as though vacant and highest and best use as improved.
Improvements	All buildings, structures, fixtures, and fences erected on or affixed to the land; all fruit, nut bearing, ornamental trees and vines, not of natural growth, and not exempt from taxation, except date palms under eight years of age.
Income approach	Any method of converting an income stream or a series of future income payments into an indicator of present value.
Interest rate	The rate of return on debt capital; the price paid for borrowing money.
Land	Real estate, or real property, except improvements. It includes: the possession of, claim to, ownership of, or right to possession of land; and all mines, minerals, and quarries in the land, all standing timber whether or not belonging to the owner of the land, and all rights and privileges appertaining thereto.

Term	Definition
Leaseback	A transaction in which an investor purchases property and leases it back to the seller, generally under lease terms and conditions that were negotiated at the time of the sale.
Leased fee interest (or estate)	The lessor's interest in property; an ownership interest held by a landlord with the right of use and occupancy conveyed by lease to others; the right to receive rent stipulated in the lease and to receive the property (the reversionary right) at the end of the lease term.
Leasehold interest (or estate)	The lessee's interest in property; the right to use and occupy real property during the term of a lease, subject to any contractual restrictions.
Lessee	One who has the right to use or occupy property under a lease agreement; a tenant.
Lessor	One who holds property title and conveys the right to use and occupy the property under a lease agreement.
Leverage	The effect of borrowed funds, which may increase or decrease the return that would be realized on equity free and clear.
Lien date	All taxable property (both state and locally assessed) is assessed annually for property tax purposes as of 12:01 a.m. on January 1, which is called the lien date. It is referred to as the lien date because on this date the taxes become a lien against all real property assessed on the secured roll.
Loan-to-value ratio	The ratio between the mortgage amount and the value of the property pledged as security for the debt; usually expressed as a percentage.
Market rent	The amount of rental income that could be expected from a property if available for rent on the open market, indicated by the prevailing rental rates for comparable properties under similar terms and conditions; distinguished from contract rent, which is the actual rental for the subject property as specified in a lease; also referred to as economic rent.
Net lease	A lease in which the tenant pays all property operating expenses in addition to the stipulated rent.
Net return	The difference between *gross return* and *gross outgo*.

Term	Definition
New construction	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 thereof or which converts the property to a different use.
Overall rate (R_o)	An income rate for a total real property interest that reflects the relationship between a single year's net operating income expectancy and the total property price or value.
Personal property	All property except real property (section 106).
Possessory interest	Interests in real property that exist as a result of (1) a possession of real property that is independent, durable and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with the ownership of a fee simple or life estate in the real property in the same person; or (2) a right to the possession of real property, or a claim to a right to the possession of real property, that is independent, durable and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with the ownership of a fee simple or life estate in the real property in the same person; or (3) taxable improvements on tax-exempt land.
Projection period	The holding period; a period of time over which net income is projected for valuation purposes; a presumed period of investment in property. [When the income approach is used to value a taxable possessory interest, the projection period corresponds to the reasonably anticipated term of possession.]
Purchase price	The amount of money a buyer agrees to pay and a seller agrees to accept in an exchange of property rights; sale price is based on a particular transaction, not necessarily on what the typical buyer would pay or the typical seller would accept.
Real property	The possession of, claim to, ownership of, or right to the possession of land; all mines, minerals, and quarries in the land; all standing timber whether or not belonging to the owner of the land, and all rights and privileges appertaining thereto; and improvements; in California property tax law, the term is synonymous with "real estate."

Term	Definition
Regular assessment roll	Roll covering period starting July 1 of the current calendar year to June 30 of the next year. Assessment period for the regular roll must be completed on or before July 1.
Remaining economic life	The estimated period during which the improvements will continue to contribute to a property's value.
Replacement cost	The cost required to replace an existing property with a property that has equivalent utility.
Reproduction cost	The cost required to reproduce an exact replica of an existing property.
Reversion	A lump-sum benefit that an investor receives or expects to receive at the termination of an investment. [In a taxable possessory interest, the land and improvements that revert back to the public owner at the termination of the taxable possessory interest.]
Reversionary interest	The rights of the lessor at the expiration of a lease; the estate returned or due to be returned.
Risk	Uncertainty about the outcome of future events; uncertainty about the future profitability of investments or projects; the possibility of not receiving the projected income.
Salvage value	The value of property at the end of its economic life in its present use.
Secured property	Property on the secured roll.
Secured roll	That part of the assessment roll containing state assessed property and property the taxes on which are a lien on real property sufficient, in the opinion of the assessor, to secure payment of taxes.
Structure	An edifice or building; an improvement whose primary use or purpose is for housing or accommodation of personnel, personalty, or fixtures and has no direct application to the process or function of the industry, trade, or profession.
Sublease	An agreement in which the lessee in a prior lease conveys the right of use and occupancy of a property to another.
Supplemental assessment	An assessment of the full cash value of property as of the date a change in ownership occurs or new construction is completed,

Term	Definition
	which establishes a new base year value for the property or for the new construction.
Taxable value	For real property subject to article XIII A of the California Constitution, the base year full value adjusted for any given lien date as required by law or the full cash value (market value) for the same date, whichever is less, as set forth in section 51(a). For personal property, the full cash value for the lien date each year.
Unsecured property	Property on the unsecured roll.
Unsecured roll	See definition of secured roll. Remainder of the roll is the unsecured roll. The taxes [based on an assessment on the unsecured roll] are a personal liability of the owner.
Weighted average	An average that is calculated by weighting each component by a factor that represents its relative importance to the whole, multiplying each component by its assigned weight, and adding the products; used in the band of investment method.
Yield capitalization	A capitalization method used to convert future benefits to present value by discounting each future benefit at an appropriate yield rate or by developing an overall rate that reflects the investment's income pattern, value change, and yield rate. [Also called annuity capitalization.]
Yield rate	A measure of investment return (usually annualized) that is applied to a series of incomes to obtain the present value of each; examples are the interest rate, the discount rate, the internal rate of return, and the equity yield rate.