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No. 78/137

TO COUNTY ASSESSORS:

VALUATION OF PRIVATE, FEE-OWNED PROPERTY
SUBJECT TO LEASE AGREEMENTS

Here is another in the series of letters concerning implementation of Article XIIIA of the Constitution. The enclosed questions and answers illustrate the proper valuation procedures to be followed when valuing private, fee-owned property subject to lease agreements.

Revenue and Taxation Code Section 110.6 states that the creation, sublease, and assignment of a leasehold for a term in excess of ten years constitutes a change of ownership. A leasehold is the right of use and occupancy of real property by virtue of a lease agreement. Those rights covered by a lease agreement are known collectively as the leasehold.

Since changes of ownership of leasehold interests do not constitute a change of ownership of the entire property, only that portion of the property rights leased will be subject to revaluation. The fee rights retained by the lessor (reversion) will continue to be valued at the base year factored value until the fee interest is sold. When title to the fee simple estate passes from one party to another, the entire property will be revalued as of the date of change and factored forward with appropriate CPI adjustments.

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

Sincerely,

Walter R. Senini
Assistant Executive Secretary
Property Tax Department

WRS:sk
Enclosures

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

1. QUESTION: How would you handle the valuation of a private, fee-owned property in which a lease is created in January 1978 for an eleven-year period?

ANSWER: The leasehold will be valued as of the date of creation and the value factored forward with appropriate CPI adjustments. The reversionary rights, since no change of ownership has occurred, will retain their 1975 base value subject to appropriate factoring.

EXAMPLE: Assume the market value of the property as of March 1, 1975 was $50,000, and the value of leasehold interest based on a capitalization of the rental income was $30,000. By subtracting the value of the leasehold interest from the market value of the total property, the result is the amount attributable to the reversionary rights in 1975 or $20,000. The March 1, 1978 taxable value of the total property would be determined as follows (assuming 1978 market rent):

Leasehold:	$6,000	(net annual market income)	
	x 6.4951	(PW 1/P @ 10% for 11 years)	
			$38,971
Reversion:	$20,000		
	x 1.0612	(CPI adj. for 3 years)	
			$21,224
			$60,195
		SAY	$60,200

2. QUESTION: How would you value a private, fee-owned property in which a lease is signed for a nine-year period?

ANSWER: According to Section 110.6, a newly created lease with a term of less than ten years duration does not constitute a change of ownership. The property would, therefore, retain its 1975 full value, factored forward.

3. QUESTION: Can options be considered when determining the ten-year term?

ANSWER: Length of options should be added to the specified term of the lease where it is likely that the option will be exercised.

4. QUESTION: How do you value a private, fee-owned property subject to an eleven-year lease when the lease was assigned to a third party in January 1976?

ANSWER: In accordance with Section 110.6, the assignment of leased property rights with a term in excess of ten years constitutes a change of ownership. The "leased rights" are the only portion of the total property experiencing the change of ownership and would, therefore, be revalued as of the 1976 base year. The reversion would retain its 1975 full value, factored forward. The sum of the factored reversion plus the revalued leased portion constitutes the total taxable value for the 1976 lien date. The valuation procedure would be similar to that illustrated in the example of the new lease created for an eleven-year period.

5. QUESTION: How would you value a private, fee-owned property subject to a lease in 1975 in which only the lease, with less than ten years remaining, is assigned in January 1976?

ANSWER: A newly created or assigned lease, ten years or less in duration, does not constitute a change of ownership under the provisions of Section 110.6. Therefore, the property would retain its 1975 full value factored forward at two percent annually to the appropriate lien date.

6. QUESTION: How would you value a private, fee-owned property subject to a lease when the property is sold?

ANSWER: In accordance with Section 110.6, the sale of the fee simple estate constitutes a change of ownership of the entire property and, therefore, would necessitate a revaluation of the total property as of the date of sale, factored forward to the appropriate lien date.