STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**4/10/07**	Bill No:	**AB 530**
Tax:	**Property**	Author:	**Salas**
Related Bills:			

BILL SUMMARY

This bill would expand the possessory interest property tax exemption for military housing to also include non-family military housing and modify the types of uses to which a private contractor may utilize the resulting property tax savings.

ANALYSIS

Current Law

Section 107.4 of the Revenue and Taxation Code provides that a private contractor's interest in rental military *family* housing is not subject to property taxation as a possessory interest, provided certain requirements and conditions are met.

Existing law, subdivision (m) of Section 107.4, provides that any reduction in property taxes, or, if unknown, the contractor's reasonable estimate of property tax savings, inures solely to the benefit of the residents of the military housing through property improvements such as a child care center provided by the private contractor.

Proposed Law

Bachelor Housing. This bill would amend Section 107.4 to delete the word "family" throughout its text. Thus, the exemption could also apply to the privatization of unaccompanied housing (i.e., bachelor housing).

Property Tax Saving Beneficiaries. In addition, this bill would amend subdivision (m) of Section 107.4 to instead provide that property tax savings could be used over the life of the project (50 years) through the construction of additional housing units, the renovation of military housing units, and/or the construction of amenities or other improvements intended to serve the current or future residents of the military housing.

In General

In certain instances a property tax assessment may be levied when a person or entity uses publicly-owned real property that, with respect to its public owner, is either immune or exempt from property taxation. These uses are commonly referred to as "possessory interests" and are typically found where an individual or entity leases, rents or uses federal, state or local government property.

Revenue and Taxation Code Section 107 sets forth the three essential elements that must exist to find that a person's use of publicly-owned tax-exempt property rises to a level of a taxable possessory interest. The use must be independent, durable and exclusive.

Section 107(a)(1) defines "independent" to mean "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[1] to constitute more than a mere agency."

Property Tax Rule 20(c)(8), a regulation, additionally require that a possessor derive "private benefit." "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."

Section 107.4 provides a possessory interest exemption for a private contractor's interest in rental military *family* housing, by stating that the contractor's interest in the property is not "independent" when certain criteria are met.

RELATED LEGISLATION

In 2004, Senate Bill 451 (Ch. 853, Ducheny) added Section 107.4 to the Revenue and Taxation Code to provide that a possession or use of land or improvements is *not* independent if that possession or use is pursuant to a contract, including, but not limited to, a long-term lease, for the private construction, renovation, rehabilitation, replacement, management, or maintenance of housing for active duty military personnel and their dependents, if specific criteria are met. An interest that is not independent fails to meet one of the three necessary elements for the interest to be subject to property tax. Thus, a private contractor's interest in military housing meeting the eligibility criteria of Section 107.4 would be exempt from property tax.

In 2006, Senate Bill 1400 (Ch. 251, Kehoe) added subdivision (o) to Section 107.4 to define the phrase "military housing under military control." It defined a "military facility under military control" as a military base that restricts public access to the military base. SB 1400 clarified that privately-developed military housing not located on a military base that restricts public access does not qualify for the military housing possessory interest tax exemption. Shortly after enactment of Section 107.4, concern arose that the statute might not adequately define the term "military housing under military control," and that more expansive interpretations of the military housing possessory interest exemption might be advanced by developers of off-base military housing. The definition refinement was made to avoid an interpretation that Section 107.4 exempts all privatized military housing from the possessory interest tax by creating the bright line test of public access. San Diego County sponsored the legislation because they have a number of privatized military housing projects, some of which are eligible for exemption and others which are not.

BACKGROUND

Congress established the Military Housing Privatization Initiative (MHPI) in 1996 as a tool to help the military improve the quality of life for its service members by upgrading the condition of their housing. The MHPI was designed and developed to attract private sector financing, expertise and innovation to provide necessary housing faster and more efficiently than traditional Military Construction processes would allow. The military enters into agreements with private developers selected in a competitive process to

[1] Property Tax Rule 20(c)(5) specifies that to be "sufficiently autonomous" constitutes 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."

own, maintain and operate family housing via a fifty-year lease. The Department of Defense maintains an extensive website on the MHPI program at http://www.acq.osd.mil/housing.

In 2003, Congress authorized the Department of the Navy to undertake up to three pilot projects for the privatization of unaccompanied housing (i.e., bachelor housing). The various services call unaccompanied housing by different names, such as bachelor enlisted quarters, barracks and dormitories. The Navy selected Clark Pinnacle to redevelop Naval Station San Diego as part of the first large-scale public-private venture to provide housing for single military personnel. The Clark Pinnacle proposal was selected through competitive biding. Clark Pinnacle is a partnership between Clark Realty Capital, a real estate and construction company headquartered in Bethesda, Md., and Pinnacle, a real estate investment management firm headquarted in Seattle. Construction broke ground in January of 2007.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author. Its purpose is to ensure that the private contractor's interest in bachelor housing is also exempt from property tax.
2. **The first project to privatize bachelor housing is located in San Diego, California.** The first pilot project, Pacific Beacon LLC, privatizes 258 units of Navy-owned unaccompanied housing units and provides for the construction of 941 apartments at Naval Station San Diego. Construction commenced this year and is scheduled for completion in 2009. The LLC will own, operate, and manage the project, which consists of 1,999 units, for 50 years. **www.pacificbeacon.com**
3. **Why not exempt bachelor housing too?** Given that the precedent of an exemption for family housing has been established by law, it seems appropriate to extend the exemption to housing provided for military service personnel living in non-family housing projects.
4. **Property tax savings are to inure to the benefit of the military families and service personnel rather than to the private contractor.** Current law requires that any reduction in property taxes on leased property used for military housing under the MHPI will inure solely to the benefit of the residents of the military housing through improvements, such as a child care center provided by the contractor. Other sections of law extending a property tax exemption to an otherwise non-tax exempt entity similarly require that property tax savings inure to the worthy organization in question, via rent reductions. (See Section 202.2 related to property leased to a public school, university or college or leased to a library or museum that is free to the public. And Section 206.2 related to property leased to churches). In this case, rather than reducing the rents charged to service personnel, the contractor is to insure that the property tax savings are used to provide additional improvements. Assessors are currently monitoring their compliance with this provision.
5. **This bill modifies the allowable uses of the property tax savings.** First, it provides that the property tax savings could be used over the life of the project, which is 50 years. Assessors note that this extension makes this element of the law impossible to administer since it removes any method by which an assessor could assure that the private contractor is complying with the requirement that the savings

inure to the benefit of the military residents living in the housing. Additionally, it provides that, rather than specific improvements for the military residents of the housing community, the savings could be used to construct or renovate more units. It is unclear if more units would be built, given that it appears the number of units is specified for in contract. On the other hand, giving the private contractor more flexibility allows them to decide how the money is to be spent on things that are needed. According to the Department of Defense, the property tax implications of these projects are not guaranteed. The website to potential bidders notes: "Are property taxes considered in these deals? Although DoD will not negotiate with the local jurisdiction on any tax abatements, the developer is free to negotiate to achieve any tax abatements." http://www.acq.osd.mil/housing/faqs.htm#27

COST ESTIMATE

The Board would incur insignificant costs (less than $10,000) to inform and advise county assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Under the MHPI Act authorized by Congress in 1996, the military has made significant progress in privatizing on-base family housing units. Although the specifics of the implementation plans developed by the Army, the Air Force and the Navy, including the Marine Corps, vary, the basic framework of their deals are very similar.

- Lease land to private contractor/developer for 50 years.
- Convey existing family housing units and infrastructure to the contractor/developer for replacement or renovation.
- Contractor/developer to build additional family housing units, as required.
- Contractor/developer will be responsible for property management, including repairs and maintenance.
- Tenant costs including utilities may not exceed basic allowance for housing (BAH).
- At the end of the contract, the military authority will own the housing units.

Under current law, MHPI family housing projects are not treated as taxable possessory interests. This treatment would be extended to privatized unaccompanied military housing, or barracks, under this bill.

In 2003, Congress authorized the Department of the Navy to undertake up to three pilot projects for the privatization of unaccompanied housing. The first pilot project, Pacific Beacon, privatizes 258 units of Navy-owned unaccompanied housing units and provides for the construction of 941 apartments at Naval Station San Diego. The ground-breaking ceremony for the project was held in January 2007; the project is scheduled for completion in 2009.

According to Department of Defense, the second pilot project is planned for Virginia while the third would take place in the Pacific Northwest, if feasible.

The estimated assessed value for the Pacific Beacon project upon its scheduled completion in 2009 is $100 million. The annual revenue impact in 2009 can then be estimated

$$\$100 \text{ million} \times 1\% = \$1.0 \text{ million}$$

REVENUE SUMMARY

The annual revenue loss at the basic one percent property tax rate is estimated to be $1.0 million by 2009.

QUALIFYING REMARKS

Depending on the success of the pilot unaccompanied housing privatization projects, Congress may decide to authorize the privatization of other unaccompanied housing quarters as well. The revenue impact of this bill would increase significantly if all such housing quarters were privatized.

Analysis prepared by:	Rose Marie Kinnee	(916) 445-6777	3/19/07
Revenue estimate by:	Aileen Lee	(916) 445-0840	
Contact:	Margaret S. Shedd	(916) 322-2376	

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