



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/19/10	Bill No:	<a href="#">SB 1250</a>
Tax:	Property	Author:	Ducheny
Related Bills:			

### BILL SUMMARY

This bill would expand the property tax exemption on possessory interests available to private contractors that operate military family housing projects to those that operate housing projects for single, unaccompanied, or married service members without dependents.

### 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 taxable possessory interest, provided certain requirements and conditions are met.

#### PROPOSED LAW

This bill would amend Section 107.4 to delete the word "family" throughout its text. Thus, the exemption would also apply to the privatization of unaccompanied housing (i.e., housing for enlisted service members without dependents). In practical application, this bill would apply to property located in San Diego County, the site of the nation's first large-scale privatized housing community for unaccompanied military personnel.

**Retroactive Operative Date.** These provisions are applicable to military housing projects for which a private contractor entered into a lease agreement with the military on or after January 1, 2005. §107.4(p)

#### 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 "taxable 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 or entity'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 of rights held by others in the property.

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<sup>1</sup> to constitute more than a mere agency.”

Property Tax Rule 20(c)(8), a regulation, additionally requires that a possessor derive a “private benefit” from the use of the property. “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. Thus, if qualified, these interests will not be deemed to be a *taxable* possessory interest.

#### LEGISLATIVE HISTORY

In 2004, Senate Bill 451 (Ch. 853, Ducheny) added Section 107.4 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” 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 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 restricted 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.

Last year AB 1332 (Salas) would have also expanded the exemption available to private contractors that operate military family housing projects to those that operate housing projects for single enlisted service members. In addition, it would have also refined and expanded upon the requirement that the property tax savings from the exemption inure solely to the benefit of the residents of the military housing projects. Furthermore, it would have detailed the documentation and information that the assessor may request from the private contractor to administer the exemption. This San Diego County sponsored bill was held in Assembly Appropriations.

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<sup>1</sup>Property Tax Rule 20(c)(5) specifies that “[t]o 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.”

Also in 2009, AB 1344 (Fletcher) would have expanded the taxable possessory interest property tax exemption available to private contractors that operate military family housing projects to those that operate housing projects for single enlisted service members. It would have also modified various provisions that require that the property tax savings from the exemption extended to the private contractor to inure solely to the benefit of the residents of the military housing projects. That bill was held in the Assembly Revenue and Taxation Committee.

### 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 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. 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 bidding. 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 headquartered in Seattle. Construction broke ground in January 2007 and was substantially completed in March 2009.

### COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by San Diego County “to allow military housing (both single and family) provided under a long-term lease held by a private contractor to be exempt from possessory interest classification for annual property tax assessments if the tax savings from the housing projects are applied towards improvements for the housing residents above and beyond the contract requirements.”
2. **Supporters note that the need for affordable quality military housing exists for all military service men and woman regardless of whether they have a family.** By removing the designation of “family” housing, any housing project for military service members that otherwise qualifies under Section 107.4 would benefit from the possessory interest tax exemption.
3. **The first project to privatize bachelor housing is located in San Diego.** The first pilot project, Pacific Beacon LLC, privatized 258 units of Navy-owned unaccompanied housing units (Palmer Hall) and provides for the construction of 941 apartments at Naval Station San Diego (Pacific Beacon). The LLC owns, operates, and manages the project for 50 years.

A March 26 press release states: “The Department of the Navy and Clark Realty Capital celebrated the grand opening of Pacific Beacon today at Naval Base San

Diego. As the nation's first large-scale privatized housing community for unaccompanied military personnel, Pacific Beacon sets a new tradition in excellence by offering luxury living to single service members stationed in the San Diego metro area. The three luxury high-rise residences will serve as home to over 1,800 unaccompanied service members stationed in the San Diego metro area. Developed through a public-private venture between the Department of the Navy and Clark Realty Capital, Pacific Beacon opened its first building to residents in December of 2008. The entire project achieved substantial completion on March 12, 2009. The community constructed by Clark Construction Group and Clark Builders Group features 941 dual master suites and unique, resort-style amenities that rival any luxury high-rise apartment building in San Diego. The units are all priced at or below the Basic Allowance for Housing (BAH) rates of qualified residents.”  
[www.pacificbeacon.com](http://www.pacificbeacon.com)

4. **Retroactive Provisions.** If these provisions are enacted, any outstanding taxes would be cancelled and any property taxes previously paid would be refunded, subject to the statute of limitations on refunds.

## **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 is 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.

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, privatized 258 units of Navy-owned unaccompanied housing units and provided for the construction of 941 apartments at Naval Station San Diego. The ground-breaking ceremony for the project was held in January 2007.

According to the San Diego County Assessor's Office, the assessed value for Pacific Beacon for the 2009-10 assessment roll is \$197 million. The annual revenue impact is estimated to be \$2.1 million.

$$\$197 \text{ million} \times 1.076\% \text{ (average tax rate)} = \$2.1 \text{ million}$$

**REVENUE SUMMARY**

The estimated annual revenue loss from the Pacific Beacon project is \$2.1 million.

**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.

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*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*