



(916) 324-6594

September 4, 1985

Dear Mr.

Proper Treatment of Lease Property Upon Change of Ownership

This letter is in reply to your letter to Mr. Richard Ochsner dated July 18, 1985 in which you request our advice with respect to the following facts described in your letter.

The problem concerns a number of properties located in the Bass Lake Resort and recreation area of Madera County. These properties are leased to private individuals from one of two master leaseholders who have leased the property from PG&E. The subject "subleases" originally were for a period in excess of 35 years. However, the leases are scheduled to terminate in approximately 2011 or 2012 and therefore presently have less than 35 years remaining. The "Master Lease" expires in 2013.

The question faced by Madera County concerns how it should treat secondary and vacation homes built upon this leased property when a change in lessee occurs. A sale of a leased property typically occurs through use of a document entitled "Assignment of Lease" between the parties, and a document entitled "Consent to Assignment" by which the "master leaseholder" gives its consent to the "assignment".

The main question is whether (and if so, how) the change of lessee can be treated as a change of ownership of the improvements located on the leased property. You have considered the following theories and have requested our comments with regard to each.

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1. That transfer of an interest in the subject leased property constitutes a change of ownership pursuant to Revenue and Taxation Code* Section 61(c)(1) in that it is actually a termination of a leasehold interest in taxable real property which had an original term of 35 years or more.

Comment - We agree that this theory is "suspect" because in reality there is a transfer of a leasehold interest rather than a termination thereof. Since the remaining term of the leasehold interest transferred is less than 35 years, the transfer does not constitute a change in ownership as indicated by Property Tax Rule 462(f)(2)(A)(ii).

2. That pursuant to Section 61 (third paragraph) the presumption of the existence of a renewal option of at least 35 years on the lease is applicable to all subject lease properties in that the homes are eligible for the homeowners' exemption regardless of whether the owner of the home is in fact eligible for the homeowners' exemption.

Comment - We agree that this theory is not workable because Section 218 specifically provides that the homeowners' exemption does not extend to a vacation or secondary home. Further, Section 218 requires ownership of the dwelling in question. If the sublessee acquired ownership of the improvement on an assignment of the sublease, there would be no need to presume the existence of a renewal option of at least 35 years because assignment of the sublease would result in a transfer of a fee simple interest in the improvement.

3. That the County may treat the transfer of the subject properties as changes of ownership under Section 60, pursuant to Section 61(c)(1) as a transfer of a leasehold interest having a remaining term of 35 years or more (including renewal options), based upon the County's recognition of an unspoken renewal option or option to purchase which most likely will be offered prior to expiration of the "subleases". The subject subleases do not contain anything in writing concerning the existence of a renewal option or option to purchase, but it is widely believed that a renewal option or option to purchase will be offered prior to the expiration of the subleases. The fact that sublessees are placing hundreds of thousands of dollars worth of improvements on leased property is evidence of the generally perceived existence of a renewal or repurchase option.

* All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

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Comment - Since the "Master Lease" expires in 2013, PG&E would have to renew that lease before the subleases could be renewed. To our knowledge, that has not been done nor are we aware of any such renewal option in the "Master Lease." There is an option to purchase the land from PG&E in the "Master Lease" as indicated below, however, that option does not arise until after the expiration of the subleases. Although sublessees are placing hundreds of thousands of dollars worth of improvements on leased property, that fact alone does not, in our opinion, prove the existence of a renewal option. There may, of course, be additional facts of which we are unaware which would establish the existence of such option. To be valid, however, an option to renew must be in writing either in the lease or otherwise unless there is an estoppel. (Hagenbuch v. Kosky (1956) 142 Cal.App.2d 296, 300.)

As I indicated to you in our telephone conversation concerning this matter, one possible basis for reappraisal is that the improvements are legally owned by the sublessee so that an assignment of a sublease would be a transfer of a fee simple interest in the improvements rather than a transfer of a leasehold interest therein. With respect to the two subleases you provided us, however, this possibility seems to be negated by the provisions (Paragraph 4 of the Williams lease and Paragraph 3 of the Pines lease) which require that improvements placed on the leased property must remain on the property at the termination of the lease. Since the sublessee has no right of removal nor the right to be compensated with respect to the improvements, the sublessee can hardly be said to be the owner of the improvements under those subleases.

Since the land is owned by PG&E and is thus assessed at market value annually by the Board, you further ask whether the Board could similarly assess the improvements erected on the leased land. Under Article XIII, Section 19 of the California Constitution, the Board must assess the improvements in question if they are owned or used by PG&E. I don't believe there is any question here that the improvements are not used by PG&E. Whether PG&E owns the improvements in question must be determined by examining the documents collectively comprising the "Master Lease". An examination of those documents indicates that the lessee has the option to purchase the land from PG&E when the lease expires. If the lessee does not exercise this option, PG&E has the option to purchase the improvements from the lessee. If neither option is exercised or before the options expire, the lessee has the right to remove the improvements. (See Lease between A. G. Wishon (PG&E's predecessor in interest), lessor and William B. Day,

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lessee dated December 5, 1906.) From the foregoing provisions, it seems clear that PG&E is not the owner of the improvements in question. The Board, therefore, has no jurisdiction to assess these improvements.

Based on the foregoing, we see no legal basis to reappraise the improvements upon the assignment of a sublease such as those discussed above. Nor, as indicated above, do we believe there is any legal basis for the Board to assess the improvements in question.

If we can be of further assistance in this matter, please let us know.

Very truly yours,

Eric F. Eisenlauer
Tax Counsel

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