

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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No. 30/147

October 7, 1930

TO COUNTY ASSESSORS:

CHANGE IN OWNERSHIP - OPTIONS

Transactions involving options require careful analysis on the part of the assessor when determining base year values. Options may involve lease terms, purchase conditions, or a combination of the two.

Lease options are specifically covered in Board Rule 462(e)(1) which states that "The calculation of the term of a lease...shall include written renewal options." In other words, the 35-year lease term pertaining to the revaluation of properties subject to long-term leases is determined by combining the terms of the base lease and renewal options.

Purchase options are not specifically covered by current statutes. The general rule is that a change in ownership occurs when the option is exercised. Exceptions to this rule do occur, however, when the agreement is not truly an option but is actually a form of sales agreement or contract.

A sales contract creates a mutual obligation. One party is obligated to sell and the other to buy within a limited time. A purchase option obligates only the selling party. Even though the potential purchaser (the optionee) has no legal obligation to purchase the property, there are circumstances where he is economically compelled to complete the transaction. This would occur whenever the optionee would realize a significant and immediate equity in the property merely by exercising the option. For example, if the option specifies a selling price that is significantly less than the current market value, or in the case of a lease/purchase option, when the lessee is paying more than economic rent and the excess is being applied toward the purchase price, a sales contract would exist. When significant equity is present at the time the option is originated or it can be determined at the time of origination that equity will be established with certainty within a short period, the option is a form of sales agreement and revaluation should occur as of the date the option was created.

Because of the uncertainties involved, there will be very few cases where an option can legitimately be considered a sales contract. Making an incorrect assumption that a sales contract is present will cause the assessor to make two revaluations—one when the option originates and one when the option term expires without being exercised—when in reality no revaluation should have occurred.

October 7, 1980

The variability of option provisions and the subjectivity of option analysis make it mandatory that each option be individually analyzed, taking into consideration both the phraseology of the contract and the intent of the parties.


EXAMPLES

- (1) On September 1, 1980, "A" acquired a three-year option to purchase a property from "B" for \$150,000 which is a reasonable estimate of the fair market value of the property as of September 1, 1980. As the \$150,000 may be more or less than fair market value of the property as of September 1, 1983, "A" has no proven economic compulsion to exercise his option. Reappraisal would take place only when and if the option is exercised.
- (2) "A" leases a building from "B" for three years beginning September 1, 1980 and, in addition to the lease, has an option to purchase the building at termination of the lease for \$100. The rental paid by "A" is considerably above economic rent and the option terms allow "A" to apply the excess rent to the purchase price if he exercises the option. "A" states he is purchasing the property and this lease/purchase option allows him to build equity without making a down payment.

In this instance the option is actually a sale agreement as "A" is purchasing equity regularly with excess rental payments. "A" would lose the equity if he did not exercise the option. The property should be revalued as of the date the option originated.

If you have comments or questions on this subject, please contact the Technical Services Section of this division, (916) 445-4982.

Sincerely,

  
Verne Walton, Chief  
Assessment Standards Division

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