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September 24, 2008

**Re: Taxability of Improvements and Land Leased at Vandenberg Air Force Base
Assignment No. 08-033**

Dear Mr. _____ :

This is in response to your request for an opinion letter asking whether a lease of United States government (the Government) land (the Land) to _____ Housing LP (_____ Housing), a Delaware limited partnership, on which improvements (the Improvements) will be built by _____ Housing, would give rise to: (1) a fee simple in the Improvements on the Land or (2) a possessory interest in the Improvements and the Land.¹ You have indicated that your client, _____ Military Housing LLC, a wholly-owned subsidiary of _____ Trust, a Maryland real estate investment trust (LLC), will possess an ownership interest in _____ Housing through related entities.

As explained in further detail below, in our opinion, the transfer of title in the Improvements from the Government to _____ Housing merely transferred bare legal title and left the beneficial ownership of the Improvements in the hands of the Government. Furthermore, with regard to the leasehold (the Lease), the Lease subordinates the interests of _____ Housing to those of the Government to such an extent that _____ Housing appears to serve primarily as an agent of the Government for purposes of building and managing the military housing project (the Project). For this reason, we believe that the proposed arrangement between _____ Housing and the Government does not result in the creation of a taxable possessory interest under California Revenue and Taxation Code² section 107.

¹ When referring to both the Land and the Improvements including all non-structural fixtures, we employ the term "Project."

² All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Factual Background

Chronology

On September 7, 2007, you and Mr. _____, acting as counsel to LLC, met with Mr. Robert Lambert and me to request an opinion letter concerning the proposed lease of land from the Government to _____ Housing. On October 3, 2007, the Legal Department produced an opinion letter, which found in pertinent part that _____ Housing exercised so little control over the proposed military housing project to be built on the Land that it failed to satisfy the independence prong for a taxable possessory interest under section 107.

On November 1, 2007, officers for the Government and _____ Housing signed the Lease and other Project documents. The Government also executed a “quitclaim deed” that purported to convey its entire interest in the Improvements to _____ Construction, subject to certain restrictions on the use of the property imposed by the Government. The deed was recorded in Santa Barbara County on November 2, 2007.

Also on November 1, 2007, _____ Construction executed a “quitclaim deed” that purported to convey its entire interest in the Improvements to _____ Housing subject to certain restrictions on the use of the property imposed by the Government. The deed was recorded in Santa Barbara County on November 2, 2007.

Also on November 1, 2007, you state that the title company retained by _____ Housing filed a preliminary change of ownership report (PCOR) with Santa Barbara County relating to the transfer from _____ Construction to Vandenberg Housing. Among the information divulged on the PCOR was that there was a cash payment in the amount of \$7,800,000 and a first deed of trust in the amount of \$127,300,000.

On February 6, 2008, the office of the County Clerk, Recorder and Assessor of Santa Barbara County sent us a letter asking that we opine on several issues related to the Project, including the taxable status of the Improvements.

On March 4, 2008, the Legal Department rescinded the October 3, 2007, opinion letter in order to gather new information related to the Improvements.

On March 14, 2008, we met for a second time with you and Mr. Turner in order to request several additional items of additional information relating principally to the Improvements.

On April 10, 2008, you provided written responses to the questions that we posed at the March 14, 2008, meeting along with copies of the executed Project documents.

On July 22, 2008, the Government and _____ Housing executed the First Amendment to Department of Air Force Lease of Property (the First Amendment), which modified Section 9 of the Lease to provide that the Improvements would revert to the Government at the end of the Lease term.

The Improvements

1. **Interest Transferred:** The Government executed a document entitled a “quitclaim deed” on November 1, 2007 that purported to convey all of the Government’s interest in the Improvements to [redacted] Construction LLC, a Delaware limited liability corporation ([redacted] Construction) subject to certain restrictions on the use of the property imposed by the Government (The First Deed). The Improvements, located within Vandenberg Air Force Base in Santa Barbara County, include existing military housing and “ancillary improvements,” fixtures and personal property within the housing units and certain specified utility systems.³ Also on November 1, 2007, [redacted] Construction executed a “quitclaim deed” that was virtually identical to the First Deed, which purported to convey an interest in the Improvements to [redacted] Housing subject to certain restrictions on the use of the property imposed by the Government (the Second Deed).
2. **Use of the Improvements:** [redacted] Housing will demolish and rebuild or retrofit 1,336 existing units on the Long-Term Parcel and create a grand total of 867 units on the Long-Term Parcel for use as military housing.⁴
3. **Reversions, Conditions and Covenants:**
 - a. The Improvements are returned intact to the Government at the end of the Lease term, unless the Government exercises an option to have [redacted] Housing demolish the Improvements.⁵
 - b. The Deeds impose a number of covenants and conditions on [redacted] Housing’s interest in the Improvements: the Government retains the right to send in firefighters, the right to restrict public access to the base, the right to bar individuals from the base, the authority to conduct searches of individuals, the right to use the Land and Improvements for disaster preparedness and the right to enter onto the property for public health reasons.⁶
 - c. The Deeds are also executed subject to the Lease, which restricts any commercial use and/or alienation of [redacted] Housing’s lease interest.⁷

The Lease

1. **Purpose of the Agreement.** The Government is leasing two parcels (the Long Term Parcel and the Short Term Parcel) to [redacted] Housing. [redacted] Housing is required to construct a minimum of 867 units of housing intended for military personnel and their families pursuant to the Military Housing Privatization Initiative of 1996 (the MHPI).⁸

³ First and Second Deed, Schedule B; Lease, Condition 1.3.

⁴ Lease Section 6.1; Community Development Plan 2.1.

⁵ First Amendment, Conditions 9.1 and 9.3; First Deed and Second Deed, Section 1.

⁶ First Deed and Second Deed, Section 3.

⁷ First Deed and Second Deed, Section 1.

⁸ Lease, Condition 6.1; see 10 U.S.C. § 2871 et seq.

2. Lease Term. On the Long Term Parcel, the Lease is for a term of 50 years with a commencement date beginning on November 1, 2007.⁹ With regard to the Short Term Parcel, which is to be used solely as a construction staging area, the Lease term ends when construction is completed on the Larger Parcel.¹⁰

3. Consideration to the Government. \$1 per year payable by _____ Housing to the Government.¹¹

4. Scope of Operations.

a. _____ Housing is responsible for overseeing the construction contractor that will build the Project. _____ Housing will provide an \$8.2 million capital contribution to the Project and also obtain outside financing. The outside lender must be approved by the Government. You have also indicated the Government will provide some additional financing for the Project.

b. _____ Housing is responsible for the day-to-day management of the Project.¹² _____ Housing may engage management agents to operate and manage the Project and will be responsible for preventing a violation of the Lease by any management agent.¹³

5. Budget. _____ Housing must submit a project budget to the Government at least 90 days before the start of each fiscal year.¹⁴

6. Distribution of Profits. Before completion of the Project (projected at about six years after the Lease term's commencement), revenues will be used to pay the construction contractor, the lender and various accounts payable. After completion of the Project, provided that other expenses are current, monthly disbursements will be made in the following proportions:

a. 90 percent of the net revenues to the Government for reinvestment in the Project;¹⁵ and

b. 10 percent of the net revenues to _____ Housing and its affiliated entities.¹⁶

7. Restrictions on Alienation. _____ Housing may not transfer more than 5 percent of its ownership interest in the Project in any one year or more than 20 percent of its total ownership interest on a cumulative basis without Government consent.¹⁷

⁹ Lease, Condition 1.1.

¹⁰ Lease, Condition 1.4.1.

¹¹ Lease, Condition 4.1.

¹² Property Operations and Management Plan, § 1.0.

¹³ Master Development and Management Agreement, § 4.1.

¹⁴ Lockbox Agreement, § 3.02.

¹⁵ Lockbox Agreement, § 5.02(c)(xvii)(A).

¹⁶ Lockbox Agreement, § 5.02(c)(xvii)(B).

¹⁷ Master Development and Management Agreement, § 7.2.

Law and Analysis

Ownership of the Improvements

Evidence Code section 662 provides that while the transferee listed on a deed is presumed to be the owner of the full beneficial interest, this presumption may be rebutted by clear and convincing evidence. Under Rule 462.200, subdivision (b)(1), the presumption that all persons listed on the deed have an ownership interest in the property may be rebutted by “[t]he existence of a written document executed prior to or at the time of the conveyance in which all parties agree that one or more of the parties do not have equitable ownership interests.” Whether the taxpayer is able to successfully rebut the deed presumption is a factual question, for which the county assessor serves as the finder of fact. The courts define clear and convincing proof as evidence “so clear as to leave no substantial doubt in the mind of the trier of fact,” and as evidence “sufficiently strong to command the unhesitating assent of every reasonable mind.”¹⁸

In the present case, the issue is whether a quitclaim deed by the Government transferred its entire interest in the Improvements to Housing, causing a change in ownership of the Improvements.¹⁹ A quitclaim deed “. . . transfers whatever present right or interest the grantor has in the property.”²⁰ The presumption is that a grantor intends to convey a fee simple by a grant of real property “. . . unless it appears from the grant that a lesser estate was intended.”²¹

The primary object in interpreting a deed is “. . . to ascertain and carry out the intention of the parties.”²² Deeds should be construed according to the rules of interpretation governing contracts.²³ One should interpret the deed as a whole rather than looking at the deed in terms of its detached clauses.²⁴ When examining the whole of a deed, it may be possible to determine that the parties decided to convey something less than a fee simple despite the use of the words “quitclaim” on the document. As the Supreme Court of California has stated:

. . . [C]onditions which would be void as restrictions upon the alienation of a fee conveyed by the deed, may contain expressions, which show that no such fee is granted, and, in construing a deed, such language must be given its due weight. Where the intent to be gathered from the deed as a whole, including otherwise void conditions, is that a lesser estate was to be conveyed, then such intention must prevail, and . . . the effect will be that no fee is conveyed by the deed²⁵

Further, all the documents comprising a transaction must be examined together in order to determine the true intention of the parties.

¹⁸ *Tannehill v. Finch* (1986) 188 Cal.App.3d 224, 228.

¹⁹ Because it is our opinion that the deeds and the lease do not transfer a beneficial ownership interest in the Land or Improvements, the term of the lease is irrelevant for change in ownership purposes.

²⁰ *City of Manhattan Beach v. Superior Ct.* (1996) 13 Cal.4th 232, 238, quoting *Westlake v. Silva* (1942) 49 Cal.App.2d 476, 478.

²¹ Civ. Code, § 1105.

²² *Burnett v. Piercy* (1906) 149 Cal. 178, 189.

²³ *Machado v. Southern Pacific Transportation Co.* (1991) 233 Cal.App.3d 347, 352.

²⁴ *Burnett v. Piercy*, *supra*, 149 Cal. at p. 189.

²⁵ *Id.* at 190-191.

It is settled that where ‘two or more written instruments are executed contemporaneously, with reference to the other, for the purpose of attaining a preconceived object, they must all be construed together, and effect given if possible to the purpose intended to be accomplished.’²⁶

Another court has found that multiple agreements, when read together, may show an intent by the grantor to transfer something less than a fee simple.²⁷

In the present case, the existing Improvements were transferred via quitclaim deed twice on November 1, 2007. The First Deed purported to quitclaim all of the interest in the property except certain reserved interests from the Government to Construction. The First Deed purports to transfer:

. . . all of the right, title and interest of Government in and to all family housing units and ancillary improvements and all personal property contained therein (the ‘Improvements’) located on that certain tract of land lying and being situated at Vandenberg Air Force Base, Santa Barbara County, California . . . excepting those Improvements described in Schedule ‘D’ attached hereto and made a part thereof.²⁸

The First Deed includes the boilerplate language, “To have and to hold unto Grantee, and unto its successors and assigns, forever.” The First Deed also states that “. . . this instrument neither quitclaims nor conveys any interest in the land underlying the improvements.” The Second Deed, transferring the property from Construction to Housing, contains virtually identical language to the above.

Despite the use of the term “quitclaim deed” to characterize the two deeds, the First and Second Deeds reserve significant powers to the Government. Among other rights, Section 3 provides that the Government retains the right to enter onto the Land or the Improvements in order to safeguard base security. This authority includes the right to send in firefighters, the ability to restrict public access to the base, the right to bar individuals from the base, the authority to conduct searches of individuals, the right to use the Land and Improvements for disaster preparedness and the right to enter onto the property for public health reasons.

Additionally, section 3 of both the First Deed and the Second Deed provides that, “[t]his transfer is made subject to the terms and conditions of the Lease” Among other provisions, the Lease limits Housing to only 10 percent of the net revenues produced by the Project each month.²⁹ Moreover, Housing must submit all plans for the Project and the Land to the Government for review.³⁰ If there are any changes in these plans, they must be

²⁶ *Kuffel v. Seaside Oil Co.* (1970) 11 Cal.App.3d 354, 368 quoting *People v. Ganahl Lumber. Co.* (1938) 10 Cal.2d 501, 507. For interpretation of deeds in conjunction with other documents, see Civ. Code, § 1642 (“Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together.”)

²⁷ See *MacNicol v. East Coalinga Oil Fields Corp.* (1943) 22 Cal.2d 742, 749 (Lease and oil drilling contract, when read together, proved that grantor oil driller intended to reserve a 20 percent interest in drilling royalties on land sold to a third party.); *Burnett v. Piercy, supra*, 149 Cal. at pp. 190-191 (Two deeds should be read together in determining whether a man intended to create a life estate rather than transfer a fee simple interest in real property.)

²⁸ The Improvements described in Schedule D are a few specific gas and sewer lines, which are treated as easements under the Lease.

²⁹ Lockbox Agreement, § 5.02(c)(xvii).

³⁰ Master Development and Management Agreement, § 3.6.2.

approved by the Government.³¹ Housing can only charge rent based on a serviceman's Basic Allowance for Housing and a few other specific costs.³² Housing may not sublease space in the Project to any retailer of sales or services or for use as commercial recreational operations or activities without the prior written approval of the Government.³³ Finally, Housing must also reimburse the Government for police and fire protection.³⁴

Along with the substantial rights that the Government retains through the covenants and conditions in the two deeds, it is also necessary to examine the intent of the parties.³⁵

Housing has characterized the deeds as an arrangement to comply with the requirements of federal law. Specifically, a member of the armed forces may only use his basic allowance for housing to pay for "a housing unit not owned or leased by the United States."³⁶ For this reason, Housing claims that it employed a quitclaim deed, which would provide Housing with legal ownership, while the Government would continue to enjoy beneficial ownership of the property through the Lease and Deed sections that restrict Housing's rights to rents and possession. Thus, while federal law characterizes bare legal title as an ownership interest for purposes of 10 U.S.C. section 2882(b)(2), California law only taxes the beneficial ownership interest in real property.

A related ownership issue is the status of the Improvements at the termination of the Lease. In this case, both the terms of the Lease and the Deeds, contain dispositive language evidencing that the Government retains the beneficial ownership of the Improvements.

In the present case, Section 3 of the First Deed provides that:

This transfer is made subject to the terms and conditions of the Lease, including but not limited to, the requirement that under certain conditions set forth in the Lease, whether by expiration of the term or otherwise, title to all Improvements (whether hereby conveyed to Grantee [GMH Construction] or subsequently added to the Leased Premises during the term of the Lease) shall automatically revert to and become the sole and absolute property of the United States of America, acting by and through the Secretary of the Air Force (the 'Government') without compensation therefor, or, at the Government's election, the Improvements shall be removed and the Leased Premises restored at no expense to the Government, as provided in the Lease.

The Second Deed repeats virtually the same language concerning the transfer from Construction to Housing.

Condition 9.1 of the Lease, as Amended by the First Amendment, in turn, provides that:

Unless the Government delivers an Improvement Removal Notice to Lessee in accordance with Condition 9.2, then on the Term Expiration Date, or the

³¹ Master Development and Management Agreement, § 3.5.3; Lease, Condition 17.1.3.

³² Property Operations and Management Plan, § 2.1.1.

³³ Lease, Condition 6.2.

³⁴ Lease, Condition 4.2.

³⁵ *City of Manhattan Beach v. Superior Ct.*, *supra*, 13 Cal.4th at 238, quoting *Burnett v. Piercy*, *supra*, 149 Cal. at p. 189.

³⁶ 10 U.S.C. § 2882(b)(2).

effective date of a Default Termination Notice pursuant to Condition 7.3.1 or a Termination Notice for Extensive Damage or Destruction of Improvement pursuant to Condition 7.3.2, the Lessee shall terminate its operations on the Leased Premises and vacate and surrender possession without compensation thereof of the Leased Premises and the Leased Premises Improvements, whereupon all such Leased Premises Improvements shall revert to the Government. Such reversion shall be automatic and subject to all Applicable Laws. The Lessee shall execute any documentation reasonably requested by the Government to confirm or effect such reversion, which reversion shall be free and clear of any and all encumbrances other than (a) those approved by the Government pursuant to Section 5.4.1 of the Master Development and Management Agreement and (b) any existing Outgrants.

In Recital B, the parties provide the following rationale for executing the First Amendment:

The Government and the Lessee desire to amend the Lease as it applies to the restoration and surrender clause in Condition 9 of the Lease to clarify the parties' intent regarding the requirement that, subject to the terms and conditions of the Lease, at the expiration of the Lease term or otherwise, title to all Leased Premises Improvements shall automatically revert to the Government or, at the Government's election, the Lessee shall remove the Leased Premises Improvements and restore the Leased Premises as provided in the Lease.

Six years before the termination of the Lease, First Amendment Conditions 9.2 and 9.4 permits the Government to exercise an option requiring that Housing demolish the Improvements within 180 days of the termination of the Lease.

While it is true that the Lease has been in effect since November 1, 2007 and the First Amendment was not executed until July 22, 2008, it is our opinion that the First Amendment may be regarded as retroactive to November 1, 2007, because it serves to clarify the intent of the parties rather than to materially alter the agreement.³⁷ The contradiction between the Lease language and the Deeds that existed prior to the First Amendment shows that a facial ambiguity existed within the parties' documents and that the parties corrected that ambiguity to reflect their intention that the Lease should be consistent with that intent expressed in the Deeds.

Therefore, based on our examination of the Lease and the Deeds, it is our opinion that Housing has provided sufficient evidence to show that it possesses only bare legal title rather than a beneficial interest in the Improvements. By contrast, the Government intended to convey to Housing not a fee simple in the Improvements, but to create an arrangement under which Housing would hold bare legal title over the Improvements, while the Government, through the provision of onerous restrictions in the Deeds and the Lease, would retain a beneficial interest. For this reason, we do not believe that Housing owns a fee simple in the Improvements despite the fact that it is the ultimate transferee on two documents that are entitled "quitclaim" deeds.

³⁷ See *Burnett v. Piercy*, *supra*, 149 Cal. at p. 189 (Intent of parties is paramount consideration when interpreting deeds).

Taxable Possessory Interest in Land and Improvements

California Constitution article XIII, section 1 provides that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. Property owned by the United States is immune from property taxation by a state within whose territorial limits it is located unless the United States consents to such taxation.³⁸

Even though real property owned by the United States is not subject to property taxation, a private leasehold or other private possessory interest in such property may be taxable. Section 107, subdivision (a) defines a “possessory interest” as:

Possession of, claim to, or right to the possession of land or improvements that is independent, durable, and exclusive of rights held by others in the property, except when coupled with ownership of the land or improvements in the same person.

A private possessory interest in publicly-held real property is subject to property taxation as a taxable possessory interest.

Under Property Tax Rule³⁹ 20, subdivision (a)(1), a possessory interest will be found if:

1. It is durable;
2. It is exclusive of the rights held by others in the real property;
3. It provides a private benefit to the possessor; and
4. It is independent.

Durability

Rule 20, subdivision (c)(6) defines “durable” as a determinable period for which there is a reasonable certainty that the possessor’s right, claim or possession will continue. In this case, the stated lease term is 50 years. Thus, the durability requirement is satisfied.

Exclusivity

“Exclusive of the rights of others in the property” is defined as “the enjoyment of an exclusive use of real property, or a right or claim to the enjoyment of an exclusive use together with the ability to exclude from possession by means of legal process others who may interfere with that enjoyment.”⁴⁰ Most importantly in this case, one type of exclusivity is:

Concurrent uses of real property, not amounting to co-tenancy or co-ownership under subdivision (A)(2) above, by persons making qualitatively different uses of the real property.⁴¹

³⁸ See *Gottstein v. Adams* (1927) 202 Cal. 581, 584; *Rhor Aircraft Corporation v. San Diego County* (1960) 362 U.S. 628, 634.

³⁹ Property Tax Rules are promulgated under title 18 of the California Code of Regulations.

⁴⁰ Property Tax Rule 20, subd. (c)(7).

⁴¹ Property Tax Rule 20, subd. (c)(7)(A)(4).

In this case, Housing is the lessee of the Land and the legal owner of the Improvements.⁴² For its part, the Government retains all existing easements and licenses on the Land, rights to enter onto the Land and into the Improvements for security, environmental and other reasons and the right to restrict access to the site.⁴³ While both the Government and

Housing have certain legal rights to use the Land during the lease term, these rights are qualitatively different. Housing will build and operate the Project, while the Government retains ultimate responsibility for security, environmental enforcement and other concerns. Therefore, Housing's interest satisfies the exclusivity requirement for a taxable possessory interest as a concurrent use that is qualitatively different from other usufructuary rights.

Private Benefit to the Possessor

Rule 20, subdivision (c)(8) defines "private benefit" as the opportunity of the possessor to derive a profit, an amenity, or to pursue a private purpose related to its possessory interest that produces an economic benefit in which the general public does not share. In this case,

Housing receives 10 percent of the net revenues produced by the Project.⁴⁴ This compensation, exclusive of other fees or benefits, is sufficient to show that Housing derives a private benefit from the Project.

Independence

"Independent" is defined as:

. . . 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 to constitute more than a mere agency.⁴⁵

Thus, in order to be "sufficiently autonomous," the holder of the possessory interest must ". . . 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."⁴⁶

Consequently, an independence analysis focuses on the extent to which a principal/agent relationship arises between a government landowner and a private "lessee." An agent is one who represents another in dealings with third parties.⁴⁷ The existence of an agency relationship is a question of fact.⁴⁸

In the case of military housing, there are two separate analyses used to determine whether the independence prong of the definition of taxable possessory interest is satisfied. First, does

⁴² Lease, Recitals, p. 1.

⁴³ Lease, Conditions 2.1, 10.6 and 10.7.1.

⁴⁴ Lockbox Agreement, § 5.02(c)(xvii).

⁴⁵ Rev. & Tax. Code, § 107, subd. (a)(1).

⁴⁶ Property Tax Rule 20, subd. (c)(5).

⁴⁷ Cal. Civ. Code, § 2295; Witkin, 3 *Summary of California Law*, 10th Ed., Agency, § 2.

⁴⁸ *Rodriguez v. American Technologies, Inc.* (2006) 136 Cal.App.4th 1110, 1124.

the interest-holder lack independent possession or use of the land or improvements under section 107.4? If the interest-holder does not qualify under section 107.4, it is then necessary to examine whether the interest-holder possesses sufficient indicia of independence under the *Asilomar* case and its progeny (discussed below) to show that it acts as more than an agent to the Government.

1. *Independence Analysis under Section 107.4*

Section 107.4, whose effective date was January 1, 2005, provides a list of 15 requirements that, if satisfied in their entirety, will demonstrate that a private contractor is a mere agent of the federal government, and thus, does not hold a taxable possessory interest. In order to qualify under this “safe harbor” provision, the private contractor must show that *all* 15 criteria are met. If the private contractor satisfies virtually all these statutory criteria but still fails to comply with one of them, then lack of independence cannot be shown under section 107.4.

Section 107.4, subdivision (h) requires that an alleged taxable possessory interest holder prove that “[t]he military controls the distribution of revenues from the project to the private contractor.” Lockbox Agreement Section 4.01 provides that “[t]he Lockbox Agent shall establish and maintain the Accounts and Subaccounts in accordance with the terms of the Agreement” Under Lockbox Agreement Section 1.01, “Lockbox Agent” is defined as “initially, Capmark Finance Inc., a California corporation, and any successor” Distributions from the Lockbox Account are to be made by the Lockbox Agent according to specific terms laid down in the Lockbox Agreement.⁴⁹ The Lockbox Agent is responsible for investing all funds held in the Project accounts.⁵⁰ Only in the case of a default by Vandenberg Housing or its successor in interest does control pass to another party: the senior lender.⁵¹

Thus, in this case, because the Government does not control the distribution of revenues from the Project as required under subdivision (h), Vandenberg Housing cannot prove a lack of independence under Section 107.4.

2. *Independence Analysis under the Asilomar Factors*

California courts have determined the independence of a potential possessory interest based on a number of factors that indicate whether a principal/agent relationship exists.⁵² In *Asilomar*, the court determined that an organization formed to manage a state-owned conference center was sufficiently constrained by state oversight that it lacked a taxable possessory interest.⁵³ The court noted that the organization was established solely to manage the campground, all income from the operation of the conference center had to be deposited in a trust account, the capital budget had to be approved by the state and surplus funds were placed under state control.⁵⁴

In the present case, there are a number of indicia that point to control by Vandenberg Housing. However, taken together, it appears to us that the Government retains primary control over the Project and limits Vandenberg Housing’s profit to a percentage that appears to constitute a mere management agent’s share.

⁴⁹ Lockbox Agreement, §§ 5.02(b) and 5.02(c).

⁵⁰ Lockbox Agreement, § 5.13(a).

⁵¹ Lockbox Agreement, § 5.01(m).

⁵² *Pacific Grove-Asilomar Operating Corp. v. County of Monterey* (1974) 43 Cal.App.3d 675, 683-684.

⁵³ *Ibid.*

⁵⁴ *Id.* at 688-689.

Looking at the Project documents, we note the following factors that are indicative of the Government's control:

- Housing's annual base rent is \$1 per year.⁵⁵ The primary consideration to the Government appears to be the construction of the Project for use as military housing. In addition, Housing must reimburse the Government for police and fire protection.⁵⁶
- Housing may receive only 10 percent of the net revenues produced by the Project each month after construction of the Project is complete.
- Housing's return on its \$7.8 million dollar capital contribution has been capped.⁵⁷ Housing will be unable to liquidate its investment until the Lease has terminated.⁵⁸
- Housing must submit a budget for the Project to the Government for each fiscal year.⁵⁹
- Housing must submit all plans for the Project and the Land to the Government for review.⁶⁰ If there are any changes in these plans, they must be approved by the Government.⁶¹
- The Government must approve each phase of the Project's construction.⁶² All site plans and housing designs must be submitted to the Government before construction can begin.
- Housing may not transfer more than 5 percent of its ownership interest in the Project in any one year or more than 20 percent of its total ownership interest on a cumulative basis without the Government's consent.⁶³
- The Government reserves all existing easements, rights of way, licenses and other property interests of public record in the Land⁶⁴ and in the Improvements.⁶⁵ The Government may grant easements, rights of way or licenses to third parties so long as they do not ". . . unreasonably interfere with Lessee's use or the value of the Leased Premises"

⁵⁵ Lease, Condition 4.1.

⁵⁶ Lease, Condition 4.2.

⁵⁷ See Lockbox Agreement, § 5.01(l)(i) and 5.02(c)(xvi) and (xvii).

⁵⁸ See Lockbox Agreement, §§ 5.01(j) and 5.02(c)(xvi) and (xvii).

⁵⁹ Lockbox Agreement, § 3.02.

⁶⁰ Master Development and Management Agreement, § 3.6.2.

⁶¹ Lease, Condition 17.1.3.

⁶² Lease, Condition 17.2.

⁶³ Master Development and Management Agreement, § 7.2.

⁶⁴ Lease, Condition 2.1.

⁶⁵ First and Second Deeds, Section 3.

- The Government retains a security interest “in all its property including, without limitation, fixtures, and all property of the Lessee [Housing] shall be subject to a continuing lien for any sums due from the Lessee in accordance with the provisions of the Lease.”⁶⁶
- There are substantial limitations on the amount of rent that Housing may charge. “It is mutually understood by all of the partners that the maximum allowable rental income to be derived from the occupancy of family housing is the sum of the on-base resident’s Basic Allowance for Housing including renter’s insurance less an allowance for utilities.”⁶⁷ In addition, the property manager may not charge a security deposit for active duty service personnel.⁶⁸
- Housing must give preference to military personnel in renting the apartments. Only in cases where Housing is unable to achieve 95 percent occupancy from a variety of military affiliates may it rent units to the general public.⁶⁹
- Housing is a single-purpose entity that has been organized solely to lease the Land, assume legal title to the Improvements and build and manage the Project.
- Housing may not sublease space in the Project to any retailer of sales or services or for use as commercial recreational operations or activities without the prior written approval of the Government.⁷⁰
- Without the prior written approval of the Government, Housing cannot use the Land for any purpose other than constructing the Project.⁷¹
- The Government retains a right of general access to inspect the Project and the Land.⁷²
- The Government has a right to restrict access to the Project through the military base in order to maintain security.⁷³
- The Government provides all fire protection and law enforcement.⁷⁴

Taken together, these contractual clauses exceed the usual protections reserved by landlords to maintain the value of their property, such as the right to inspect, restrictions on

⁶⁶ Lease, Condition 7.6.

⁶⁷ Rental Rate Management Plan, § 2.1.1.

⁶⁸ Rental Rate Management Plan, § 4.1.1.

⁶⁹ Lease, Condition 19.10; Unit Occupancy Plan, § 1.3.1.1.

⁷⁰ Lease, Condition 6.2.

⁷¹ Lease, Condition 6.1.

⁷² Lease, “Leased Premises,” p. 2 and Condition 13.

⁷³ Lease, Condition 19.7.

⁷⁴ Lease, Condition 27.1; Property Operations and Management Plan, § 5.0.

subleasing, and default provisions. These significant restrictions on Housing's ability to control the Project also appear to exceed the contractual limitations typically imposed by government agencies in granting use rights to third parties. Instead, they appear to support the parties' intention to vest the primary right of control in the Government.⁷⁵ The Government's control over the Project is so complete, in fact, that in our opinion, it does not afford sufficient "independence" to support a possessory interest.⁷⁶

Additionally, providing military housing is part and parcel of the Government's operations. Specifically, the Government retains the ultimate control over design, construction and—most importantly—rentals, including rental amounts, the eligible tenants, renting priorities, and the number of units required to be constructed. These indicia of control far exceed the normal controls exercised by an owner over its lessee. Instead, they point to an agency relationship.

To be sure, Housing does possess some indicia of control, such as title ownership of the Improvements, its ownership of on-site utilities, its purchase option in the event of a base closure and tort liability. These factors provide Housing with more independence than was the case in *Asilomar*.⁷⁷ Similarly, it appears to us that Housing exercises greater control than was the case with a Monterey County military housing project, where the Government was a member of the LLC developing the property and the LLC's monthly profits were limited to 4 percent of rental receipts.⁷⁸

Nevertheless, we believe the onerous restrictions on control and profitability, as well as the fact that Housing's affiliated entities are merely providing services to the Government concerning the development and management of military housing, are sufficient to create a principal/agent relationship between the Government and Housing. For this reason, the requisite element of independence is vitiated.⁷⁹ In essence, Vandenberg Housing is restricted to using the Project for the benefit of the Government rather than for its own private benefit. Its benefit is more in the nature of a managerial fee than an owner's profit. Thus, Vandenberg Housing's right of use is not a ". . . usufructuary right, that is, 'the right of using and enjoying the profits of a thing belonging to another, without impairing the substance'. . . ." ⁸⁰

Accordingly, because Housing lacks independence in its leasehold on the Land and in its legal ownership of the Improvements, in our opinion, no taxable possessory interest is created.

Conclusion

In our opinion, based on the facts as we know them, Housing does not own an interest substantially equivalent to a fee simple in the Improvements. Moreover, we do

⁷⁵ See *Pagan v. Spencer* (1951) 104 Cal.App.2d 588, 592-593.

⁷⁶ See Property Tax Rule 20, subd. (a)(5).

⁷⁷ See *Pacific Grove-Asilomar Operating Corp. v. County of Monterey*, *supra*, 43 Cal.App.3d at 683-684.

⁷⁸ See Annotation 660.0172. Pursuant to Title 18, California Code of Regulations, section 5200, annotations are summaries of legal interpretations, not authority.

⁷⁹ Our opinion also extends to facilities built to support the housing units, such as child care centers, day care centers, community centers, dining facilities, and unit offices. Assuming these facilities are part of the same transaction and are subject to the same lease and deeds (in other words, there are no additional agreements governing these support facilities of which we are unaware), Vandenberg Housing's lack of independence in the management of these support facilities means that no taxable possessory interest is created.

⁸⁰ *Douglas Aircraft Company v. Byram* (1943) 57 Cal.App.2d 311.

not believe that Housing holds a taxable possessory interest in the Land or the Improvements, because its interests in both forms of property lack the requisite independence.⁸¹

The opinions expressed in this letter are only advisory and represent the analysis of the legal staff of the Board based on current law and the facts set forth herein. These opinions are not binding on any person, office, or entity.

Sincerely,

/s/ Andrew Jacobson

Andrew Jacobson
Tax Counsel

AJ:cme

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cc: Honorable Kenneth Stieger, President
California Assessors' Association

Mr. David Gau	MIC:63
Mr. Dean Kinnee	MIC:64
Mr. Todd Gilman	MIC:70

⁸¹ We do not address whether or not the future occupants of the Project may be found to be holders of taxable possessory interests in their leaseholds.