

660.0350 **Valuation.** The purchase of a possessory interest in government-owned land and of a privately-owned but partially destroyed structure located thereon constitutes a change in ownership. The new base year value of the possessory interest may be determined by various approaches to value. However, when the direct comparison method, a sales approach to value, is employed, the price paid must be augmented by the present worth of any unpaid future contract rents for the estimated remaining term of possession and by any other obligations assumed by the purchaser. When the possessory interest rent is a percentage of the gross revenue from the total property, it is appropriate to estimate anticipated income from the improvement in its restored condition in determining future contract rents to be paid. C 10/20/95.



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October 20, 1995

Dear _____,

I am responding to your letter of May 3, 1995 to _____ on requesting our opinion on the appraisal methodology utilized by the Los Angeles County Assessor in valuing the possessory interest at the Redondo Beach Pier. You also faxed the same letter to _____ a member of my staff, on May 11, 1995 and received a verbal opinion from him. In addition, Mr. _____ contacted _____ of your firm on May 24, 1995 to obtain additional information on the situation.

According to your letter and _____, the facts are as follows:

1. A fire destroyed part of the pier structure at the Redondo Beach Pier, which is located on tax exempt, publicly-owned land.
2. Subsequently, in 1991 Mr. Steve Shoemaker acquired the existing structure on the pier and the possessory interest, i.e., the right to use the pier and the right to further develop the pier, for \$1.0 million. (The possessory interest rent appears to be a percentage of the gross revenue from the rental of the space.)
3. Because the city was slow in rebuilding the damaged portion of the pier, Mr. Shoemaker filed a civil suit to force the city to rebuild the pier structure.
4. After the pier structure was rebuilt by the city, Mr. Shoemaker wanted to develop the pier. But because the previous litigation soured the relationship between Mr. Shoemaker and the city, approval for all development became difficult to obtain.

5. Therefore, in March 1995 Mr. Sherman sold the existing structure and his possessory interest to the city for about \$1.4 million.
6. The assessor assessed the 1991 change in ownership by adding to the sale price of \$1.0 million the present value of the unpaid future contract rent. The contract rent was a percentage of anticipated gross revenues.

You asked whether the appraisal methodology of including the anticipated rent from the potential development is correct. In an earlier conversation with you, he stated that the appraisal methodology used by the assessor was incorrect. However, after further consideration and discussion, for the reasons stated below, we now agree with the assessor.

Section 110.1(a) reads in part that "[f]or purposes of subdivision (a) of Section 2 of Article XIII A of the California Constitution, 'full cash value' of real property, including possessory interests in real property, means the fair market value as determined pursuant to Section 110 for . . . property which . . . changes ownership after the 1975 lien date . . . [t]he date on which a . . . change in ownership occurs."

Property Tax Rule 467 (Section 467 of Title 18 of the California Code of Regulations) provides that possessory interests renewed, extended, subleased, or assigned for any term shall be appraised at their full value as of the date of the renewal, extension, or as of the date the sublessee or assignee obtains the right to occupancy or use of the property.

As to the value of the possessory interest, Property Tax Rule 25 provides in part that:

"The value of a taxable possessory interest created, extended, or renewed after December 24, 1955 (other than on for production of gas, petroleum, or other hydrocarbons) may be measured by one or more of the following methods:

- (a) The 'comparative sales approach,' wherein the possessory interest is valued by either direct or indirect comparison as follows:

In the direct comparison method, the subject property is compared with itself on the date of a prior subsequent sale or with similar possessory interests which have been sold on dates prior or subsequent to the date as of which the property is being valued. To the sale price of such an interest there shall be added (1) the present worth of any unpaid future contract rents for the estimated remaining term of possession, (2) the value of any debt (other than the debt for future rents) assumed by the purchaser of the possessory interest, and (3) the present worth of any obligated costs of the purchaser, such as the cost of site restoration at the end of the term, less the present worth of any contractual benefits to the purchaser, such as salvage value of, or reimbursement for, improvements at the end of the term."

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From the facts presented to us it appears that the county assessor used the direct comparison method. In the direct comparison method, the subject property can be compared to itself, provided that it has sold; or, it can be compared with similar possessory interests that have been sold prior or subsequent to the valuation date of the subject property. In analyzing sales to use in the direct comparison method, the assessor must add to the sale price (1) the present worth of any unpaid future contract rents for the estimated remaining term of possession, (2) the value of any debt assumed by the purchaser of the possessory interest, and (3) the present worth of any obligated costs of the purchaser, such as the cost of site restoration at the end of the term.

In your situation, as of the date of the appraisal, it would be proper for the assessor to consider all rental income, including income from a proposed improvement, as part of the unpaid future contract rent provided that it can be reasonably presumed that the property would generate that rent. Property Tax Rule 21(f) defines contract rent as the payment in money or in kind for the right to use real property as required by the terms of the possessory interest agreement.

You argue that the assessor is assessing an improvement that does not exist when the income from that proposed improvement is included in the income stream for the possessory interest. However, in this case, the possessory interest is only the land. The improvements are owned by the taxpayer. Therefore, the unpaid future contract rents are the rents or income to the land.

The assessor is not assessing a proposed improvement. The assessor is only trying to determine all of the future benefits of the land, i.e., the possessory interest. One of the future benefits is the rent that the land could generate. This rent could be determined by a proposed improvement, as is the case here.

In addition, if the risk of building a proposed improvement is different from that of an existing building, then a different discount rate could be used for the second income stream.

I am sorry that this conclusion conflicted with an earlier one provided to you. However, due to the complexity of this issue, extensive discussion was needed before a final opinion could be rendered. If you have further questions, please contact our Real Property Technical Services Section at (916) 445-4982.

Sincerely,



Richard C. Johnson, Chief
Assessment Standards Division

RCJ:kmc

cc: Los Angeles County Assessor
Mr. Dale Edington

bc: Mr. Ricahrd Ochsner

(Prepared by Arnold Fong)