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July 8, 2010

Supervising Appraiser
Fresno County Assessor's Office
2281 Tulare Street
Fresno, CA 93721-2139

Re: Inclusion of Development Impact Fees in Full Cash Value of Property
Assignment No.: 10-039

Dear Mr. :

This is in response to your email correspondence, requesting our opinion as to whether the value of development impact fees (or impact fees) should be included in the full cash value of property upon a change in ownership when a buyer has "reimbursed" the seller, a developer, after the seller has already paid the fees to a local agency. In addition, you ask us for general guidance of how to treat such fees in the event a buyer assumes, from the developer, the obligation to pay the fees as part of its purchase of the property.

As explained below, it is our opinion that while any payment of development impact fees does not constitute "new construction" and therefore should not be assessed as newly constructed property upon payment by a developer, once a developer has paid such fees and the property changes ownership, the total consideration paid by the buyer constitutes the purchase price (which then becomes presumptively the full cash value of the property). This is true even if the parties agree and designate a portion of the purchase price as "reimbursement" of the fees. In addition, it is our opinion that if a developer agrees to pay a local agency impact fees but does not pay them prior to selling the property, the cash equivalent of the unpaid fees outstanding should be added to the balance of any other cash or cash equivalent portion of the purchased property to derive the full cash value upon the change in ownership.

Facts

Recently, your office has seen transactions where developers purchase finished residential lots in bulk from an original developer that had agreed to pay impact fees to a local agency. The original developer may have already paid the fees, in which case the buyer does not owe any additional fees, and the agreement between the original developer and buyer may be structured so that a portion of the purchase price is allocated as "reimbursement" to the selling developer of such fees. Most of the bulk lot sales your office is aware of involve a buyer that has assumed the fees that the selling developer had agreed upon with the local agency but had not paid. There are also transactions where developers buy the lots from an original developer who incurred the fees, but the buying developer does not believe that it has assumed the obligation for the fees because it is going to sell the property prior to building and will therefore pass the obligation on to another buyer, which could be either the end user homeowner or a builder.

Law and Analysis

Development Impact Fees

In California, development impact fees are governed by the Mitigation Fee Act, California Government Code §§ 66000 et seq.

Under the Mitigation Fee Act, the following terms are defined:

1. A "development project" is defined as "any project undertaken for the purpose of development" and includes "a project involving the issuance of a permit for construction or reconstruction, but not a permit to operate." (Gov't Code, § 66000, subd. (a).)

2. A "fee" is defined as "a monetary exaction other than a tax or special assessment, whether established for a broad class of projects by legislation of general applicability or imposed on a specific project on an ad hoc basis," that a local agency charges an applicant in exchange for approval of a development project to defray some of the costs for public facilities, with certain exclusions. (Gov't Code, § 66000, subd. (b).)

3. A "local agency" is defined as "a county, city, whether general law or chartered, city and county, school district, special district, authority, agency, any other municipal public corporation or district, or other political subdivision of the state." (Gov't Code, § 66000, subd. (c).)

4. "Public facilities" are defined as "public improvements, public services, and community amenities." (Gov't Code, § 66000, subd. (d).)

Under the Mitigation Fee Act, the general rule is that development impact fees charged by a local agency on a residential development project are not required to be paid until the date of the final inspection or the date the certificate of occupancy is issued,[1] whichever is earlier. (Gov't Code, § 66007, subd. (a).) However, there are different rules for fee collection for residential developments that include more than one dwelling. In those cases, it is up to the local agency to decide on one of three payment options. The developer may be required to pay fees either: (1) on a pro rata basis for each dwelling when it receives its final inspection or certificate of occupancy, whichever occurs first; (2) on a pro rata basis when a certain percentage of dwellings have received their final inspection or certificate of occupancy; or (3) on a lump sum basis when the first dwelling in the development receives its final inspection or certificate of occupancy, whichever occurs first. (*Ibid.*)

Notwithstanding those rules, a local agency may require the payment of fees earlier under certain circumstances.[2]

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[1] "Final inspection" or "certificate of occupancy" have the same meaning as described in the Uniform Building Code, International Conference of Building Officials, sections 305 and 307, 1985 edition. (Gov't Code, § 66000, subd. (e).)

[2] First, fees may be due earlier if the local agency determines that the fees will be for public improvements or facilities and an account has been established and the funds have been appropriated, and for which it has adopted a proposed construction schedule or plan prior to final inspection or issuance of a certificate of occupancy, or if the fees are to reimburse the local agency for expenditures that it has already made. (Gov't Code, § 66000, subd. (b).)

If a fee has not been fully paid before the issuance of a building permit for the construction of any part of a residential development, the local agency may condition the issuance of the permit on the property owner entering into a contract to pay the fee within the time frame set forth in Government Code section 66000, subdivision (a). (Gov't Code, § 66007, subd. (c)(1).) A contract entered into under this provision must be recorded and once recorded, the contract constitutes a lien on the property and is enforceable against successors in interest to the property owner. (Gov't Code, § 66007, subd. (c)(2).)

Property Tax

In California, property may only be reassessed upon a change in ownership or upon the completion of new construction. (Cal. Const., Art. XIII A, § 2, subd. (a), Rev. & Tax. Code, § 110.1.) The maximum amount of ad valorem tax on real property shall not exceed one percent of the property's "full cash value." (Cal. Const., Art. XIII A, § 1, subd. (a).) When a change in ownership occurs after the 1975 lien date, the "full cash value" is the appraised or fair market value of real property at the time of the change in ownership. (Cal. Const., Art. XIII A, § 2, subd. (a); Rev. & Tax. Code, § 110.1, subd. (a).) This establishes a property's "base year value." (Rev. & Tax. Code, § 110.1, subd. (b).)

Thus, when there is a change in ownership, property is reassessed at its "full cash value" or "fair market value" (herein, we use the term "full cash value"). Generally, full cash value means the amount of cash or cash equivalency that the property would bring if it had been exposed for sale in the open market under conditions where neither party could take advantage of the exigencies of the other party, and both parties had knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the any enforceable restrictions upon it. (Rev. & Tax. Code, § 110, subd. (a).)

After a purchase, the full cash value is the purchase price paid unless it is established by a preponderance of the evidence that the property would not have transferred for that price in an open market transaction. If the terms of the transaction were negotiated at arm's length, the full cash value is rebuttably presumed to be the purchase price. "Purchase price" is the cash value of the total consideration exchanged for the property, whether paid in money or otherwise. (Rev. & Tax. Code, § 110, subd. (b).)

For change in ownership purposes, Assessors' Handbook Section 502 calls development impact fees "non-assessable enhancements of land value, rather than assessable new construction."[3] Thus, when currently expended by a developer, the amounts paid to local agencies for development fees do not constitute new construction that is immediately assessed under Proposition 13 as " real property" that is "newly constructed." (See Cal. Const., Art. XIII A, § 2.) However, upon sale, an increase in the value of the land attributable to the development fees is included in the reassessed value, and would be included in the purchase price paid by a subsequent buyer. It is important to note that non-assessable enhancements to land such as impact fees are not reassessed upon completion or payment because of the limitations placed on reassessments by Proposition 13, not because such enhancements to land do not increase the value of the property. In other words, the increase in property value created by the enhancements are not captured immediately. They are captured, as required by Proposition 13, upon a change in ownership of the property, and are reflected in the purchase price paid by the buyer.

[3] Assessors' Handbook Section 502, *Advanced Appraisal* (December 1998), p. 131.

Thus, in our opinion, once a developer sells a lot for which it has already paid the fees, all amounts paid by the purchaser would constitute the "purchase price" under section 110, subdivision (b). Accordingly the full cash value would presumptively be such purchase price, even if such amounts were characterized as a "reimbursement" to the developer for the fees. This is regardless of the fact that any portion of the purchase price attributable to the fees did not constitute separately assessable property interests when originally paid. Thus, where a developer and purchaser specifically stated in a purchase agreement that a portion of the purchase price was to reimburse the developer for impact fees, the entire amount of the consideration paid, including the "reimbursement" amount, constitutes the purchase price as part of the total consideration exchanged for the property.

In the instances where an original developer negotiates with and agrees to pay a local agency for impact fees but does not pay them prior to selling the property, but instead passes them on to a subsequent buyer, the cash equivalent of the unpaid fees outstanding should be added to the balance of any other cash or cash equivalent portion of the purchase price to derive the full cash value. This is because the impact fees must be paid to the local agency and are akin to a debt assumed by any subsequent buyer. Thus, the buyer has assumed that debt and such assumption of debt is part of the consideration paid for the property.[4] This is consistent with Proposition 13 and the treatment of impact fees outlined above when they are paid by an original developer.

You also raised the fact situation where buying developers acquire property from an original developer but do not believe that they are responsible for paying the impact fees because they are going to sell the property to an end user or builder, who will need to pay the fees prior to obtaining a building permit. Even in this case, it is our opinion that the buying developer has assumed the debt of the impact fees when it acquires the property, whether it intends to actually pay the fees or not. The buying developer may, in fact, retain the property, in which it would clearly ultimately be responsible for paying the fees so the fees should properly be included as assumed debt in the purchase price. In addition, even if the buying developer sells the property prior to paying the fees, presumably any purchaser would factor its assumption of the fees into the amount of cash or cash equivalent it is willing to pay, and there is no reason why, absent any other changes to the property, the full cash value would be any different in the hands of the ultimate user or builder as in the hands of the buying developer.

Finally, we are aware that Senate Bill 1997 amended section 110, subdivision (b), effective 1998, to provide that "there is a rebuttable presumption that the value of improvements financed by the proceeds of an assessment resulting in a lien imposed on the property by a public entity is reflected in the total consideration, exclusive of that lien amount, involved in the transaction." Prior to the enactment of Senate Bill 1997, the Board of Equalization advised assessors to add the unpaid cash equivalent of any bonds outstanding to the purchase price to determine full cash value, under the rationale that the assumption of the debt is a part of the consideration paid for the property. For this reason, it might be argued that section 110, subdivision (b) relating to improvements bonds should also apply to impact fees. However, while the same logic might apply that led to the amendment of section 110, in our opinion the presumption applies only to the value of improvements financed by improvement bonds because

[4] The statutory language in section 110, subdivision (b) defining purchase price as "total consideration …, valued in money, whether paid in money or otherwise" indicates a legislative intent to include the assumption of debt as consideration. See also Rule 4, which requires assumed debt to be converted to its cash equivalent value.

it is clear from the plain language of the statute that it was intended only to apply to such improvements bonds.

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Matthew F. Burke

Matthew F. Burke
Tax Counsel III (Specialist)

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cc: Mr. David Gau MIC:63
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