



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 1799, SACRAMENTO, CA 95808)
(916) 324-6594

WILLIAM M. BEN
First District, Los An
CONWAY H. CO
Second District, Los An
ERNEST J. DRONENBURG
Third District, San C
RICHARD NE
Fourth District, Pasad
KENNETH C
Controller, Sacram
DOUGLAS D.
Executive Secre

July 2, 1986

Honorable David W. Triplett
Stanislaus County Assessor
1100 H Street
P.O. Box 1068
Modesto, CA 95353-1068

Dear Mr. Triplett:

This letter is in response to your letter to Mr. Richard Ochsner dated June 11, 1986 which sets forth the following facts:

In 1981, a local food processor built a 4.5 megawatt biomass co-generation plant which burned agricultural waste to produce electricity for sale and process steam for their food processing plant on the same parcel. The co-generation plant has been carried as a fixture on the property statement.

The electricity is sold under standard offer No. 1 (S.O. No. 1), a California Public Utility Commission (CPUC) mandated program under which P.G. & E. buys power at a price equal to the "avoided cost" of obtaining electricity and building new power plants. Under S.O. No. 1, the avoided cost is periodically recalculated and the payments adjusted. There are other co-gens that have CPUC-created, long term, fixed rate contracts but these contracts are not available to this plant.

In 1985, falling "avoided costs" resulted in a drastic reduction in payments under S.O. No. 1 so that this co-gen is now operating at a significant loss. The taxpayer has appealed the assessment claiming a Proposition 8 decline.

Based on the foregoing facts, you ask whether such a decline in value is one which you can legally recognize or whether it is like a bad lease that cannot be recognized.

As you are aware, Proposition 8, which was passed by California voters in November 1978, amended Section 2 of Article XIII A of the California Constitution to provide in relevant part:

Ch. Brown
Assistant Controller

(b) The full cash value base may reflect from year to year the inflationary rate not to exceed 2 percent for any given year or reduction as shown in the consumer price index or comparable data for the area under taxing jurisdiction, or may be reduced to reflect substantial damage, destruction or other factors causing a decline in value.

Revenue and Taxation Code Section 51 implements Article XIII A in pertinent part as follows:

51. For purposes of subdivision (b) of Section 2 of Article XIII A of the California Constitution for each lien date after the lien date in which the base year value is determined pursuant to Section 110.1, the taxable value of real property shall be the lesser of:

(a) Its base year value, compounded annually since the base year by an inflation factor

(b) Its full cash value, as defined in Section 110, as of the lien date, taking into account reductions in value due to damage, destruction, depreciation, obsolescence, removal of property, or other factors causing a decline in value.

* * *

(e) For purposes of subdivisions (a) and (b), "real property" means that appraisal unit which persons in the marketplace commonly buy and sell as a unit, or which are normally valued separately.

Property Tax Rule 461 interprets the foregoing constitutional and statutory provisions in appropriate part as follows:

(d) For the fiscal year 1979-80 and fiscal years thereafter the assessor shall prepare an assessment roll containing the base year value appropriately indexed or the current lien date full value, whichever is less. Increases and decreases in full cash value since the previous lien date shall be reflected on the roll except that taxable value shall never exceed base year value appropriately indexed....

Declines in value will be determined by comparing the current lien date full value of the appraisal unit to the indexed base year full value of the same unit for the current lien date. Land and improvements constitute an appraisal unit except when measuring

declines in value caused by disaster, in which case land shall constitute a separate unit. For purposes of this subsection fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit.

When the current full value of property is less than its base year full value indexed to the current lien date, the full value shall be enrolled as the current taxable value.

Your question of whether the situation in this case is like that of a bad lease which cannot be recognized apparently refers to the case of Clayton v. County of Los Angeles (1972) 26 Cal.App.390.

In that case, the assessor, in using the income approach to appraise a leased department store property, used the economic rent rather than the lower contract rent under the lease. The taxpayer sued for a refund on the theory that the procedure used by the assessor produced an erroneously high value. The court upheld the assessor's approach. The rationale of the case seems to be that although a bad lease may adversely affect the value of the lessor's interest (reversion), the property subject to taxation is the fee simple interest which includes the possessory interest of the lessee as well as the reversion of the lessor. Use of economic rather than contract rent is therefore required in determining the full cash value of the fee simple interest.

The facts of the Clayton case would not require the application of Proposition 8 because there was no decline in the full cash value of the fee interest. A decline in economic rent, however, is clearly a factor which would have to be taken into account for purposes of Proposition 8 because it is a factor which could cause a decline in the value of the fee interest.

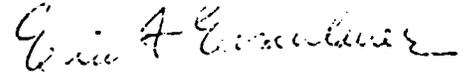
This case is distinguishable from Clayton in that no lease of the subject property is involved. The problem in a case like Clayton or this case, however, is the same and that is to estimate full cash value of the fee simple interest in the property. In doing this, the assessor in using the income approach must capitalize the net earnings that could be anticipated by a prospective purchaser and not those of the present owner of the property (De Luz Homes, Inc. v. County of San Diego (1955) 45 Cal.2d 546, 566).

The facts of this case indicate that long term fixed rate contracts for the sale of electricity are not available to the subject property. It is also my understanding that a

July 2, 1986

prospective purchaser of this property would be burdened by S.O. No. 1 to the same extent as the current owner and thus could not anticipate significantly different gross income than the current owner. Under such circumstances, the declining "avoided costs" appears to be a factor which is analogous to declining economic rent and is one which should, therefore, be taken into account in determining full cash value of the fee simple interest in the property for purposes of Proposition 8.

Very truly yours,



Eric F. Eisenlauer
Tax Counsel

EFE:cb

cc: Mr. Gordon P. Adelman
Mr. Robert H. Gustafson
Mr. Verne Walton