

## Memorandum

**To:** Mr. E. L. Sorensen, Jr.  
Chief Counsel

**Date:** February 22, 1994

**From:** Richard H. Ochsner  
Assistant Chief Counsel

**Subject: Request For Opinion:** R C

This is in response to the letter of February 11, 1994 from Mr. C requesting our opinion concerning the property tax consequences of the following facts and transactions described in his letter and set forth below.

Grand Central Square consists of several historic buildings in the middle of the historic core of downtown Los Angeles. It is considered the critical or catalytic project for the rehabilitation of the historic core, and forms a link between the Reagan state office complex on its east and the Bunker Hill financial and corporate community to the west.

Because of the historic and cultural importance of the several buildings involved, the importance of the project to the redevelopment of downtown Los Angeles, and recognizing the extraordinarily high costs of historic rehabilitation in general, the Los Angeles City Council adopted a specific measure for this project allowing the project to sell its excess development rights and to retain all proceeds from such sale(s) to be applied to the construction and rehabilitation work of the project. The City Council expressly exempted the project from the more customary policy in an excess development transfer which requires payment of a portion of the sale proceeds to the Community Redevelopment Agency. As noted, in exchange for this right, Grand Central must (1) apply all sale proceeds to the construction budget, and (2) deed away, in perpetuity, the density, or any claim to such density, transferred as part of the transaction.

During the life of the project, Grand Central entered into three sales of excess density, pursuant to the City Council's

authorization, totaling some \$10,000,000. Two sales were to the Community Redevelopment Agency itself (they are holding this excess density for subsequent sale by them to private developers), and one sale was to a third party private developer for use on a project in downtown Los Angeles.

Specifically, Mr. C requested our opinion with respect to the following question: If the buyer of excess density is assessed the full value of the purchase, then should the seller's remaining properties also be reduced in the same proportion that the value of their excess density bore to the fair market value of their land and improvements as a whole on the date ownership changed?

It is Mr. C 's belief, based upon the holding in Mitsui Fudosan v. County of Los Angeles, (1990) 219 Cal.App.3d 525, that the sale of excess density, as in this case, is a transfer of a property right--from the donor or selling site to the donee or buyer site--and that the full value of the sale would be deducted from the donor property's tax assessment and added to the acquiring property.

Since there is nothing in the facts presented which indicates otherwise, we will assume, for purposes of this opinion, that the excess density rights transferred here, as in Mitsui Fudosan, constitute a taxable real property interest the transfer of which is a "change in ownership" under Article XIII A of the California Constitution and Revenue and Taxation Code Section 60 et seq.

#### Law and Analysis

Neither Article XIII A of the California Constitution nor the statutory provisions implementing it address the question of reducing the adjusted base year value (as defined by Rev. & Tax. Code §110.1) or the taxable value (as defined by Rev. & Tax. Code §51) of real property after a transfer of a portion of such property. However, Title 18, California Code of Regulations (Property Tax Rules) section 461, subdivision (c) does address the issue as it relates to physical removal of property as follows:

The prior year taxable value of real property, or portion thereof, physically removed from the site shall be deducted from the property's prior year taxable value, provided that such net value shall not be less than zero. The net value shall be appropriately adjusted to reflect

the percentage change in the cost of living and then compared to the current lien date full value to determine taxable value which shall be the lesser of the two values.

More specifically, methods for reducing taxable value or adjusted base year value necessitated by physical removal of property are explained in Property Tax Rule 468 relating to oil and gas producing properties and Property Tax Rule 469 relating to mining properties. These rules require that the base year value of the mineral reserve be adjusted annually for depletion of the mineral resource. The rules also specify methods for calculating these annual depletion adjustments.

The basic principle underlying the foregoing property tax rules is that the taxable value of property should be reduced by the amount, and only the amount, of the taxable value attributed to the property physically removed from such property. If no value is included in a base year value for a particular improvement, then no adjustment is required if the improvement is removed. For example, if a farmer builds a barn on his property and the assessor, having no knowledge of the newly constructed barn, never adds the value of the barn to the base year value of the farmer's property so that it is, therefore, never assessed, the farmer would obviously not be entitled to a reduction in his base year value when the barn burns down. Although there are no property tax rules nor court decisions other than Mitsui Fudosan which address the reduction in taxable value as a result of non-physical removal of property, simple logic requires that the same principle apply with respect to the removal of non-physical property.

With respect to the Transferable Development Rights (TDRs) involved in Mitsui Fudosan, the Court of Appeal made the following statement at page 530: "Similarly, as the assessor's counsel acknowledged at oral argument, the base year value of the sellers' remaining properties should be reduced in the same proportion that the value of their TDRs bore to the fair market value of their land and improvements as a whole on the date ownership changed."

Inherent in the court's base year value reduction formula in Mitsui Fudosan is the notion that the TDRs were included in the base year value so that when they were sold it was proper to reduce the base year value to reflect the fact that the TDRs were no longer part of the property. It isn't clear from the decision, however,

whether the court based its formula on a factual determination that the TDRs were, in fact, reflected in the base year value or whether it believed that the TDRs were reflected in the base year value as a matter of law. It is our understanding that the formula enunciated had been considered and approved by the assessor and his counsel prior to the oral argument in the case and that the same formula continues to be the policy of the Los Angeles County Assessor's office in all such cases. This policy would suggest that the assessor considers TDRs to be reflected in the base year value as a matter of law and that in the assessor's view, the base year value reduction formula set forth in Mitsui Fudosan operates as a rule of law.

In that event, it is likely that the assessor would apply that formula for purposes of base year value reduction in this case. Following that formula, if the market value of the excess density transferred in this case was, for example, ten percent of the market value of the seller's land and improvements as a whole on the date ownership changed, the base year value would be reduced by ten percent and not by the amount of the market value of the excess density as suggested in Mr. C \_\_\_\_\_'s memorandum. Mr. C \_\_\_\_\_ or the sellers may wish to discuss this matter with the Los Angeles County Assessor's office to confirm the method of base year value reduction that would be used in this case.

With respect to the formula, however, we have reservations concerning its application if it is based on the assumption that TDRs are included in the base year value as a matter of law. In our view, it is a question of fact whether or not TDRs are included in any given base year value. For example, if the base year value is established at a time prior to the creation of or market recognition of TDRs so that there is no way that the base year value could possibly reflect TDRs as a factual matter, we don't believe application of the formula would be proper. To do so, we believe, would violate the principle underlying the property tax rules mentioned above.

We think it would follow, therefore, that if an assessor could establish, as a factual matter, that such rights were never included as part of the property for which a base year was established, the assessor could correctly argue that there should be no reduction in base year value upon the sale of such rights. The type of factual showing would probably have to be analogous to that made by the assessor in Tenneco West. Inc. v. County of

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Kern (1987) 194 Cal.App.3d 596. In that case, gas storage rights in parcels of real property were held properly valued as real property in 1978, when they were discovered, since that was the year in which they attained value due to the confluence of certain economic and technological factors. Because the rights were undiscovered, and consequently had no value, prior to 1978, they were held to be not included in the 1975 base year value established pursuant to Proposition 13.

We are not aware of any assessors who have taken that position with respect to property rights such as those involved here, however.

Mr. C mentioned that Grand Central Square consists of several historic buildings but did not mention whether those buildings were valued for property tax purposes as enforceably restricted historical property pursuant to Revenue and Taxation Code sections 439-439.4. If so, this case would be distinguishable from Mitsui Fudosan in that assessment as historical property is not subject to Proposition 13 (Rev. & Tax. Code §52, subd. (a)) and thus is not based on the base year value of the property. Without further facts, we are unable to tell what effect, if any, the sale of excess density would have on the assessment of Grand Central Square as enforceably restricted historical property.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county. As indicated above, Mr. C may wish to consult the Los Angeles County Assessor in order to determine how the described property will be assessed.

RHO:ba

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