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Executive Secretary

January 5, 1987

Attn:

Dear

This is in response to your letter of December 10, 1986, in which you request our opinion regarding the change in ownership implications of a provision in a lease which grants to the lessee the right of first refusal.

The transfer in question resulted from the death on September 6, 1985, of the owner of the real property. At the time of death, the property was subject to a lease with a remaining term of 29 years. The assessor determined that a change in ownership had occurred upon the death of the lessor and reappraised the property accordingly.

Under the terms of the lease, the lessee is responsible for payment of property taxes. The lessee contends that the lease provision which grants to him the right of first refusal to extend the lease constitutes a written renewal option of 10 years and that the remaining term of the lease at the time of the owner's death was, therefore, not 29 years but 39 years. He asserts that the transfer of the lessor's interest is not a change in ownership since the property at the time of the lessor's death was subject to a lease with a remaining term of 35 years or more.

You have provided a copy of the subject lease. The 15-page lease has a term of 50 years, commencing April 1, 1964, and terminating March 31, 2014. Paragraph number 26, page 14, entitled Right of First Refusal to Extend Lease contains the following language:

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Upon the expiration of the 50 year term of this Lease, if Lessor should desire to continue leasing said premises, Lessee shall have the right of first refusal to rent same, said right of first refusal to Lessee to continue for a period of not less than ten (10) years after the expiration of the 50 year term, provided that during all of the said ten (10) year period Lessor desires to rent said premises.... Nothing contained in this right of first refusal to lease shall in any way prevent Lessor from selling said property, taking possession of it himself and leasing same as an owner directly to the individual tenants on the property (emphasis added). This only has to do with the right of Lessee to lease the whole of the property from Lessor if Lessor offers such property to a third party for the Lease as a whole, and Lessor has received an offer of Lease from said third party.

Section 60 of the Revenue and Taxation Code (all section references contained herein are to the Revenue and Taxation Code) states that:

A "change in ownership" means a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.

Included within the definition of change in ownership is:

The creation of a leasehold interest in taxable real property for a term of 35 years or more (including renewal options), the termination of a leasehold interest in taxable real property which had an original term of 35 years or more (including renewal options), and any transfer of a leasehold interest having a remaining term of 35 years or more (including renewal options) (Section 61(c)).

As a counterpart to Section 61(c), Section 62(g) specifically excludes from the definition of a change in ownership:

Any transfer of a lessor's interest in taxable real property subject to a lease with a remaining term (including renewal options) of 35 years or more.

These statutory provisions are interpreted by subdivision (f) of property tax Rule 462, which provides, in pertinent part:

(1) The following transfers of either the lessee's interest or the lessor's interest in taxable real property constitute a change in ownership of such real property:

* * *

(B) The transfer of a lessor's interest in taxable real property subject to a lease with a remaining term of less than 35 years:

(2) The following transfers of either the lessee's interest or the lessor's interest in taxable real property do not constitute a change in ownership of such real property.

* * *

(B) Lessor's interest:

(i) The transfer of a lessor's interest in real property subject to a lease with a remaining term of 35 years or more, whether to the lessee or another party.

* * *

(4) The calculation of the term of a lease for all purposes of this section shall include written renewal options.

Under these code and rule provisions, the subject transfer of the lessor's interest would not constitute a change in ownership only if the right of first refusal to extend the lease for a ten-year period could be equated with a written renewal option, thus extending the remaining term of the lease to 39 years. However, unlike a renewal option, a right of first refusal to extend a lease does not give the lessee an absolute right to a new term; it only allows the lessee such a right conditioned upon the lessor's willingness to lease the property again at the end of the original term (Ablett v. Clauson (1954) 43 Cal.2d 280; Nelson v. Reisner (1958) 51 Cal.2d 161). It merely gives the lessee preference over a stranger, and does not preclude the lessor's retention of the property (4 Miller & Starr, Current Law of Calif. Real Estate § 27:29, p. 271). In contrast, a renewal option creates in the lessee a specifically enforceable contractual right to compel the renewal of the lease upon the terms of the option (Ibid.).

The language employed in the lease quoted above indicates clearly that the lessor was under no obligation to renew the lease. The lease states specifically that the right of first refusal to lease granted to the lessee does not prevent the lessor from selling the property or taking possession of it himself and leasing directly to individual tenants. The only right granted to the lessee by the right of first refusal

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clause is the right to lease the whole of the property from the lessor if the lessor offers the property to a third party for the lease as a whole and the lessor has received an offer from the third party. Such a right is not the same as a contractual right to compel renewal of the lease.

Under these circumstances, we conclude that the assessor's determination that a change in ownership occurred upon the transfer of the lessor's interest was correct.

We hope this information is of service to you. Please contact us again if we can be of any further assistance.

Very truly yours,

Barbara G. Elbrecht

Barbara G. Elbrecht
Tax Counsel

BGE/rz