

JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS
455 Golden Gate Avenue
San Francisco, California 94102-3688

Report

TO: Members of the Judicial Council

FROM: Policy Coordination and Liaison Committee
Hon. Marvin R. Baxter, Chair
Donna S. Hershkowitz, Assistant Director, Office of Governmental Affairs,
916-323-3121, donna.hershkowitz@jud.ca.gov
Brad Heinz, Senior Attorney, Office of the General Counsel,
415-865-7671, brad.heinz@jud.ca.gov

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SUBJECT: Judicial Council–Sponsored Legislation: New Long Beach Courthouse:
Possessory Property Tax Exemption (amend Gov. Code, § 70391.5)
(Action Required)

Issue Statement

Existing law makes property owned by the State of California exempt from property tax. However, if a private entity has a “possessory interest” in the public property, it is subject to property tax. Two financing models were proposed in the request for proposals (RFP) issued for the construction of the new Long Beach Courthouse. Either structure could (though not necessarily would) be deemed by the taxing authority as a private entity having a possessory interest in the courthouse, subjecting the property to an estimated property tax of \$4–5 million annually. The RFP expressly provided that should any possessory interest tax apply, that cost would be passed from the private entity to the Administrative Office of the Courts (AOC). Had a more traditional construction approach been selected for the Long Beach Courthouse, rather than using a performance-based infrastructure (PBI) delivery model, the courthouse would not be subject to property tax. To ensure that the property is not subject to taxation in this manner, legislation should be enacted to specify that this transaction will not result in the property being subject to a possessory interest tax.

Recommendation

The Policy Coordination and Liaison Committee recommends that the Judicial Council sponsor legislation in 2010 to amend Government Code section 70391.5 to provide that any possessory interest that may arise from a lease or other agreement with a nongovernmental entity for delivery of the new Long Beach Courthouse be deemed

public property and exempt from tax that would attach if it were deemed a private entity having a possessory interest in public property. (See attached language.)

Rationale for Recommendation

The following background information on the new Long Beach Courthouse was in the request for proposals issued by the AOC:

In June 2007, the AOC completed a review of a potential project to repair or replace the existing court building in the City of Long Beach, California (City). Based on an analysis of the relative costs and benefits of new construction versus repair of the existing court building, AOC staff recommended that the State construct an entirely new facility to replace the existing court building. This option addresses a current space shortfall; increases security; replaces a seismically and functionally deficient facility; addresses current accessibility issues; and provides space for future growth. The new building will provide an unprecedented full-service location for judicial services in the south district of Los Angeles County. . . .

AOC staff also recommended that the project be developed utilizing a public-private partnership delivery method, which is referred to in this RFP as “Performance-Based Infrastructure” or “PBI” delivery. This delivery method gives the State an opportunity to receive a new court facility that is anticipated to reduce the State’s total capital and operating costs through the PBI entity’s ability to leverage revenues from non-court uses of the new building and other means developed by the Project Company. . . .

It is anticipated that the AOC will lease all or a portion of the Court Building Site to the Project Company under a 50-year Ground Lease, which the Project Company may use to ensure the AOC’s performance of the Project Agreement. . . .

The Project Company is responsible for designing, building, commissioning, financing, and maintaining the Court Building; designing, renovating, commissioning, and maintaining the Parking Structure; and for providing specified Operating Services. . . .

The Project Company has exclusive responsibility for financing the entire Project including design, construction, commissioning, operations and long-term maintenance. . . .

The Term of the Project Agreement is 35 years from the Occupancy Date. The Term may be extended only for certain specified Relief Events. The Ground Lease will terminate when the Project Agreement expires, but will

survive for up to 50 years if the Project Agreement is terminated for AOC's default and the AOC does not pay the required termination payment or for certain other events. . . .

The Project Company will be responsible for any tax imposed by the City, or any agency of the County, the State, or the federal government. The Project Company will be responsible specifically for the payment of any applicable possessory interest tax that may be imposed on the Project by the County. If a possessory interest tax is imposed, the AOC will reimburse the Project Company for its proportionate share based upon the percentage of Superior Court space to the Leased Space in the Court Building and the percentage of Superior Court space to total available space in the Parking Structure, but only to the extent the County has not exempted such Superior Court space from the possessory interest tax.

The RFP allows for two possible financing structures for the project. The first assumes a ground lease of the land from the AOC to the project company. The project company will arrange financing and construct the courthouse. It will sublease the courthouse to the AOC, to Los Angeles County (for use by justice system partners such as the district attorney or public defender), and to retail and commercial tenants. Under this structure, referred to as a lease/lease back, legal title to the land would belong to the AOC. The second possible financing structure, referred to as bond financing, assumes a ground lease from the AOC to a tax-exempt 501(c)(3) corporation, which would finance the construction through the use of tax-exempt bonds. The project company would be retained under a management agreement to operate and manage the project.

Three proposals were received in response to the RFP and are currently being evaluated. It is anticipated that a project company will be selected in early March and construction will begin in mid-July 2010.

The AOC obtained advice from outside tax counsel that, whether the bidders propose a lease/lease back structure or a bond financing structure, it is possible that the transaction might result in the project company being deemed to have a possessory interest in public property, making the property subject to taxation. Tax counsel concluded that there is considerably less likelihood of such a determination if the proposal is for a bond financing structure with a 501(c)(3) corporation; however, even with that financing structure there remains a possibility that the project company will be found to have a possessory interest in the property.

The proposed language amending Government Code section 70391.5 is modeled after Streets and Highways Code section 143(o). That section was amended in 2006 (Assem. Bill 1467; [Núñez and Perata], Stats. 2006, ch. 32) to provide that any lease entered into by the Department of Transportation or regional transportation agencies with a private

entity for the construction and lease of toll road projects is deemed to be public property for a public purpose and exempt from property tax. The language of section 143(o) is:

A lease to a private entity pursuant to this section is deemed to be public property for a public purpose and exempt from leasehold, real property, and ad valorem taxation, except for the use, if any, of that property for ancillary commercial purposes.

The Policy Coordination and Liaison Committee recommends adopting similar language to provide that the ground lease, a management agreement, or other such agreement concerning the Long Beach Courthouse does not create a possessory interest in the project company, thereby subjecting the courthouse to property tax.

Alternative Actions Considered

Staff of the AOC Office of the General Counsel considered not pursuing a statutory change but rather securing a commitment from the county that, whichever financing structure was selected for the delivery of the Long Beach Courthouse, the county would not deem the project company as having a possessory interest in the public property and therefore not find the property taxable. Staff subsequently determined that the county would not be permitted by law to agree not to assess this tax, but rather that a statutory change would be required.

Staff also considered making the language broad enough to cover the Long Beach Courthouse and future projects for the construction of new courthouses that use a PBI delivery model. Staff concluded, however, that at this time the language should be limited to the Long Beach Courthouse and that other PBI projects should be addressed in the future.

Finally, staff considered not seeking any change. This approach was rejected, however, as the cost of not exempting this financial structure from a possessory interest property tax could be considerable, costing the judicial branch \$4–5 million annually for the term of the lease or management agreement with the project company.

Comments From Interested Parties

None.

Implementation Requirements and Costs

Failure to enact this proposal could result in the assessment of a possessory tax of \$4–5 million annually against the entity with which the Administrative Office of the Courts will contract for development of the Long Beach Courthouse, which would be passed back to the AOC. Enactment of this proposal would eliminate the possibility of this tax being assessed.

Attachment

Section 70391.5 of the Government Code would be amended to read:

1 **70391.5**

2 (a) The Judicial Council shall develop performance expectations for court facility
3 proposals, including benchmark criteria for total project life-cycle costs, project cost
4 comparisons to traditional delivery and financing options, project risk assessments and
5 allocations, utility and energy conservation requirements that meet or exceed state
6 standards, and court security operations cost controls and reduction goals. The
7 performance expectations and benchmark criteria shall be consistent with Chapter 1016
8 of the Statutes of 2002, Chapter 488 of the Statutes of 2006, and consistent with all
9 current state building practices.

10 (b) In reviewing any court facility proposal that includes a public-private partnership
11 component, the Director of Finance shall take into consideration any terms in the
12 proposal that could create long-term funding commitments and how those terms may be
13 structured to minimize risk to the state's credit ratings. Following the approval of any
14 court facility proposal of the Director of Finance, the Judicial Council shall notify the
15 Joint Legislative Budget Committee of the performance expectations and benchmark
16 criteria for the proposal at least 30 days prior to the release of initial solicitation
17 documents for a court facility project. If the Joint Legislative Budget Committee does not
18 express any opposition or concerns, the Judicial Council may proceed with the
19 solicitation 30 days after giving that notice.

20 (c) Any possessory interest resulting from a lease or other agreement with a
21 nongovernmental entity entered into pursuant to this section for the delivery of the new
22 Los Angeles County–Long Beach Courthouse is deemed to be public property for a
23 public purpose and exempt from leasehold, real property, and ad valorem taxation, except
24 for the use, if any, of that property for ancillary commercial purpose.