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DATE: October 24, 2002
TO: Gary Halbert, Chief Deputy Director, Planning Department
FROM: Kristin Schenone, Deputy City Attorney
SUBJECT: Surplus Funds in FBA, DIF and CRD Accounts

MEMORANDUM OF LAW

QUESTION

What is the appropriate disposition of surplus funds remaining in Facilities Benefit Assessment accounts, Development Impact Fee accounts, and Cost Reimbursement District accounts?

SHORT ANSWER

The appropriate disposition of such funds depends on the source of the funds and the specific authorization for the establishment of the financing method.

BACKGROUND

The City of San Diego Progress Guide and General Plan set forth the parameters for orderly and planned development in the City. The General Plan requires that developers be responsible for providing public improvements necessary to serve new development. For each

community, San Diego has adopted a Public Facilities Financing Plan which provides for the use of several financing methods to pay for the public facilities which will be needed in the community as the result of development. These plans detail the public facilities needed in a community based on the proposed or anticipated development, the estimated costs of those facilities, and the apportionment of those costs through various financing methods. The primary financing methods include Facilities Benefit Assessments (FBA), Development Impact Fees (DIF), and Cost Reimbursement Districts (CRD).

Over the years, these financing methods have created numerous accounts to pay for the public facilities needed in the communities. As the public facilities have been completed, some of the accounts have remaining balances. The question has been raised regarding the permissible uses of these surplus funds.

DISCUSSION

Initially, the permissible uses of money remaining in accounts will depend on the type of financing method which created the account. This discussion addresses accounts established with FBA, DIF, and CRD funds. In addition, each account with surplus money should be examined on a case-by-case basis to determine if the terms of the resolution establishing the account or the terms of any contractual agreements with the parties address the use of surplus money in the accounts. This analysis is meant to provide a general framework for the legal restrictions on the use of surplus money in various accounts, but is not conclusive as to specific accounts without a review of the specific documents involved in establishing each account.

A. Facilities Benefit Assessment Accounts

FBA accounts are established pursuant to San Diego Municipal Code [SDMC] sections 61.2200-61.2216 and are used to finance public facilities. Initially, the establishment of the FBA requires three actions by the City Council. First, on application of a property owner, or on its own motion, the City Council adopts a Resolution of Initiation. Next, the City Council adopts a Resolution of Intention to designate an area of benefit to be assessed for public improvements. SDMC § 61.2204. Finally, following a noticed public hearing, the City Council adopts a Resolution of Designation which establishes the area of benefit and the amount of the facilities benefit assessments against each parcel within the benefitted area. SDMC § 61.2208.

The amount of the facilities benefit assessment is determined by information on proposed public facilities contained in the financing plan for the community, an estimated cost of those facilities, and a proposed apportionment of the cost of the facilities among the properties in the area of benefit in proportion to the estimated benefit received by each property.

The assessments on each parcel are recorded and become a lien against the property. The assessments must be paid by the property owner prior to building permit issuance or approval of a final map. SDMC § 61.2210. Adjustments to the amount of the assessments may be made annually by City Council resolution to reflect increases or decreases in the actual costs of the

public facilities or estimated cost changes of the public facilities projects. SDMC § 61.2212. If an annual adjustment reduces the amount of the assessment, any amounts in the fund which are no longer required for public facilities must be refunded to the current property owner in proportion to the amount of the original payment. SDMC § 61.2215(a).

If it is determined that the public facilities projects will not be required or could be financed by another method, the FBA can be terminated by resolution of the City Council. SDMC § 61.2214. If the FBA is terminated, any money remaining in the fund must be returned to the current record owner of the property in proportion to the amount of the original payment. SDMC § 61.2215(c).

Facilities Benefit Assessments have been upheld by the courts as a valid exercise of San Diego's police power to finance public improvements through assessment procedures. *J.W. Jones Companies v. City of San Diego*, 157 Cal. App. 3d 745 (1984). Courts have consistently rejected the argument that San Diego's FBA Ordinance is a tax, subject to voter approval, and have found that the public improvements to be financed through the FBA conferred direct benefits on the properties within the area subject to the assessment and are therefore properly characterized as assessments. In making that determination, however, the courts have emphasized that the crucial feature of a benefit assessment is that it must confer a special benefit upon the property assessed beyond that conferred generally. *Knox v. City of Orland*, 4 Cal. 4th 132, 142 (1992).

Moreover, it has been held that if the assessment exceeds the actual cost of the improvement, the exaction is a tax and not an assessment. *City of Los Angeles v. Offner*, 55 Cal. 2d 103, 112 (1961). "[A]n assessment exceeding the cost of the improvement, so as to furnish revenue to the city, would violate the general principle of equality stated in...our state Constitution." *Id.* at 109. The governing body cannot authorize a special assessment for a local improvement in an amount which exceeds the actual cost of the improvement and necessary incidental expenses. *Id.* at 108.

Therefore, any money remaining in FBA accounts must be used for public improvements identified in the financing plan which confer a benefit on the property assessed. If money is remaining in the FBA accounts, the methodology determining the amount of the assessments could be found to be flawed because the money remaining would indicate that the assessment exceeded the actual cost of the public improvements.

In order to avoid a challenge to the assessments, the amount of the assessment or the facilities identified in the financing plan should be adjusted in accordance with the Municipal Code provisions to reflect increases or decreases in the actual costs of the public facilities or cost changes of the public facilities projects. In order for the assessment to be valid, under existing case law and the provisions of the Municipal Code, any remaining money could not be transferred to the general fund or used for any other purpose. Therefore, if funds are no longer needed to finance public improvements in the area of benefit, the remaining money should be returned to the current record owner of the property in proportion to the amount of the original payment.

B. Development Impact Fee Accounts

Development impact fees are assessed pursuant to California Government Code section 66000 et seq. ("DIF statute"). The general requirements of state law govern the City's application of these fees to development projects.

California Government Code section 66000 provides that a local agency must identify the purpose of the fee, identify the use to which the fee is to be put, demonstrate a reasonable relationship between the fee imposed and the proposed development's burden on the community, demonstrate a reasonable relationship between the need for the public facility and the type of development project on which the fee is imposed, and demonstrate a reasonable relationship between the amount of the fee and the cost of the public facility or portion of the public facility. Cal. Gov't Code § 66001.

Further, fees collected pursuant to this section must be expended solely for the purpose for which the fee was collected and any interest earned on that fund must also be deposited in the same account and expended for the same purpose. Cal. Gov't Code § 66006. Once sufficient funds have been collected to complete the public improvements, and the public improvements remain incomplete, any fees remaining unexpended or uncommitted must be committed within 180 days of the determination that there are sufficient funds for the improvements or must be refunded to the current owners of the lots in the development from which they were collected on a prorated basis including any interest accrued on the funds. Cal. Gov't Code § 66001(e).

In addition, once every five years, the City must make specific findings regarding the unexpended funds including identifying the purpose to which the fee is to be put, demonstrating the reasonable relationship between the fee and the purpose charged, identifying the sources and amounts of funding anticipated to be needed to complete the improvements, and identifying the dates on which the remaining funds needed are expected to be deposited into the account. If the findings are not made, the City must refund the money to the current owners of the lots in the development from which they were collected on a prorated basis including any interest accrued on the funds. Cal. Gov't Code § 66001(d).

The only limited exception to the refund requirements is if the administrative costs of refunding the unexpended funds would exceed the amount to be refunded. In that case, following a noticed public hearing, the City may use those unexpended fees for some other purpose which serves the project on which the fee was originally imposed. Cal. Gov't Code § 66001(f).

As a practical matter, DIFs are imposed, and the requirements of the DIF statute are satisfied, through the adoption of the financing plans for various communities in the City. It is essential that the City continue to identify the public improvements which the fees will be used to construct and that the amount of the fees directly correspond to the cost of the public improvements in the financing plans. When the City imposes the DIF, it is legally required to find a nexus between the amount of the fees and the public improvements to be provided with the fees. Any surplus amount would undermine the findings that the fees have a reasonable

relationship to the cost of the public improvements. The fees collected, therefore, must be expended solely on the public improvements identified in the financing plans and cannot be used for any other purpose.

Moreover, as required by the DIF statute, even the interest earned on the fund must be deposited back into the fund and used for the construction of the public improvements identified in the financing plans. As a result, any surplus funds in an account, including any portion of that money representing interest earnings, cannot be transferred to the general fund or expended for any purpose other than the public improvements identified in the financing plans.

Further, the specific language of the DIF statute requires the fees to be committed to the specific public improvements within certain time frames and requires certain findings to be made. If the City does not comply with the statute, the unexpended fees, and any interest earned on those fees, must be refunded to the current property owner in accordance with the requirements of the DIF statute.

C. Cost Reimbursement District Accounts

Cost Reimbursement Districts are established pursuant to San Diego Municipal Code sections 62.0208-62.0210 and California Government Code section 66486. CRDs are financing mechanisms used to reimburse developers when their proposed development is conditioned on the construction of public improvements which exceed in size, capacity, number, or length that which is needed to serve their development and which benefit properties outside their development area.

CRDs are established following notice to the affected property owners and a public hearing. To establish the CRD, the City Council approves a resolution that establishes the area benefitted by the public improvements, estimates costs of the public improvement, and apportions those costs among the benefitted properties based on the benefit obtained by each property. A Resolution of Lien is then approved by the Council indicating the assessments against each benefitted property within the district. Once the construction of the public improvements is complete, and the final costs have been verified by audit, the City Engineer adjusts the lien amounts to reflect the actual costs of the public improvements in the proportion of benefit to each property and records the lien against the property. SDMC § 62.0208(j). The lien must be paid by the property owner prior to building permit issuance or approval of a final map. SDMC § 62.0208(k).

Following notice by the City Treasurer to the developer that money collected from payment of the liens is in the fund, the developer must claim it within three years following the notice or the money is forfeited to the City, and it is to be transferred to the general fund. SDMC § 62.0208(l). Therefore, pursuant to Municipal Code section 62.0208(l) the developer has an affirmative obligation to claim the money due under the reimbursement agreement.

The crucial distinction allowing remaining money in a CRD fund to be transferred to the general fund, as opposed to the prohibition on doing so with the other funds, is that the funds

may not be reimbursed to the developer until all costs included in the CRD have been verified by audit as valid costs for construction of the public improvements. As a result, the CRD liens represent the actual costs of the improvements spread in proportion to each property's benefit. Since the CRD lien is a payment for a benefit already conferred, instead of a future projected benefit, the amount of the lien payment does not present the issue of whether the amount of the lien exceeded the cost of the improvements. Therefore, the money collected represents the actual costs of the improvements and the benefit received. Any remaining money in the fund, therefore, does not represent an assessment which ultimately exceeded the cost of the improvements, but instead results from the failure of the developer to collect the money. Thus, money remaining in a CRD account three years after notice to the developer in accordance with the Municipal Code requirements may be transferred to the general fund of the City.

CONCLUSION

Any money remaining in FBA funds or DIF funds must be used to finance the public improvements identified in the financing plans or refunded to the current property owners. Money remaining in a CRD fund may be transferred to the general fund of the City if not collected by the developer entitled to the money within three years following notice from the City Treasurer that money collected from payment of the liens is in the fund.

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