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MEMORANDUM OF LAW

DATE: June 15, 2010

TO: Alex Ruiz, Acting Public Utilities Department Director

FROM: City Attorney

SUBJECT: Discounted Water and Sewer Capacity Charges

INTRODUCTION

A capacity charge is basically a one-time charge for a new, additional, or larger connection to the City's water or sewer system. The charge covers the right to connect to the existing system as well as for the need to provide for existing and new facilities that will benefit the property being connected. Section 66013(b)(3) of the California Government Code defines "capacity charge" as follows:

[A] charge for public facilities in existence at the time a charge is imposed or charges for new public facilities to be acquired or constructed in the future that are of proportional benefit to the person or property being charged, including supply or capacity contracts for rights or entitlements, real property interests, and entitlements and other rights of the local agency involving capital expense relating to its use of existing or new public facilities. A "capacity charge" does not include a commodity charge.

City Council Policy 900-12 [Council Policy], entitled the Business and Industry Incentive Program, seeks to promote a sound and healthy local economy and stable growth in sales taxes revenue for the City by attracting and retaining major revenue and job generating projects and businesses through offers of financial incentives and other assistance. Discounted capacity charges are one of the incentives that are available to certain businesses and projects such as affordable housing developments.

QUESTION PRESENTED

May the City offer discounted water and sewer capacity charges to affordable housing development projects and businesses as an incentive to promote economic development?

SHORT ANSWER

Yes, but only if the water and sewer funds are reimbursed the amount of the discount, in light of legal and contractual requirements that water and sewer fund revenues are sufficient to cover the costs of providing those services but also do not exceed the costs of those services.

ANALYSIS

City ordinances mandate the payment of capacity charges before a person can have the benefit of water or sewer service. *See* SDMC sections 64.0410¹ (sewer) and 67.0513² (water). The City sets minimum capacity fees by resolution. The current minimum water capacity charge is \$3,047 per “equivalent family unit” also known as equivalent dwelling unit (EDU). *See* San Diego Resolution R-302380 (Mar. 5, 2007). The current minimum sewer capacity charge is \$4,124 per EDU. *See* San Diego Resolution R-302378 (Mar. 5, 2007). In 1996, the City Council adopted San Diego Resolution R-287543 [Resolution], which decreased the existing minimum water and sewer capacity charges (to \$2,500 each) and also established alternative, discounted capacity charges of \$1,500 each that could be offered to affordable housing projects, new residential construction in City-approved redevelopment areas, and certain businesses that met the criteria of the Council Policy. The Council Policy had been adopted in 1993 with the passage of San Diego Resolution R-282497 and was originally called the Sales Tax Incentive Program. Discounted capacity charges were not originally included among the economic incentives. In 2001, the Council Policy was amended to add “[r]educing water and sewer capacity charges by \$1,000 per equivalent dwelling unit (San Diego Resolution R-287543)” to the list of incentives that the Mayor³ had the discretion to authorize.

¹“When any person, firm, corporation or other entity shall request a new sewer connection, an additional connection, a larger connection or in any other way increase the flow into the sewer by the addition of an equivalent family unit or units, a minimum capacity charge . . . shall be paid. . . . In any case, this sewer capacity charge must be paid before the sewage flow increase is accomplished, unless otherwise provided for by a resolution of the City Council.”

²“[A minimum capacity charge] shall be paid when any person, firm, corporation or other entity shall request a new water connection or in any way cause an increase in the water usage by the addition of any type of dwelling, commercial or industrial unit...”

³ The Council Policy refers to “City Manager.” Pursuant to section 260(b) of the City Charter, all executive authority, power and responsibility conferred on the City Manager under the City Charter have been transferred to the Mayor, in accordance with the current “Strong Mayor” form of government.

As will be discussed more fully later in this memorandum, the Council Policy and the Resolution do not accurately cross-reference each other. This results in inconsistencies and even conflicts between the two regarding the precise amount of the discounted capacity charges incentive and the eligibility criteria.

A. May the City Offer Discounted Capacity Charges as an Economic Incentive?

In order to determine whether the City may offer discounted capacity charges as an economic incentive, the various laws and other legal restrictions that affect capacity charges must be examined. State law limits the maximum amounts that a municipality or agency may impose as capacity charges—this is commonly known as the “cost of service” limitation.⁴

. . . those [capacity] fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed, unless a question regarding the amount of the fee or charge imposed in excess of the estimated reasonable cost of providing the services or materials is submitted to, and approved by, a popular vote of two-thirds of those electors voting on the issue.

Cal. Gov’t Code section 66013(a).

In the various opinions and legal memoranda analyzing section 53 of the City Charter (which established the water utility fund and sets forth the permissible uses of the revenues deposited therein) this office has consistently concluded that it requires the water department to remain a self-sustaining, financially independent utility. *See, e.g.,* City Att’y RC 2010-6 (Feb.4, 2010); City Att’y MOL No. 2006-6 (Mar.16, 2006); 1980 Op. City Att’y 83. Similar restrictions and limited permissible uses are prescribed for the sewer department and sewer fund pursuant to San Diego City Municipal Code section 64.0403. Accordingly, the sewer department and sewer fund are also required to be self-sustaining and financially independent. *See* City Att’y MOL No. 2007-4 (Apr. 3, 2007); City Att’y MOL No. 2006-6 (Mar.16, 2006); 1994 City Att’y MOL 635.

Provisions in the water and sewer bond covenants restrict the use of water and sewer fund revenues, which in turn impact capacity charges. The master installment purchase agreements for the water and sewer bonds both prohibit the free service or use of the water or sewer systems. Section 6.15 of the Amended and Restated Master Installment Purchase

⁴ It should be noted that capacity charges are not subject to the provisions of Proposition 218 regarding assessments (*i.e.* art. XIII D of the California Constitution). *See Richmond v. Shasta Community Services District*, 32 Cal.4th 409 (2004).

Agreement (January 1, 2009) governing water bonds provides in pertinent part: “To the extent permitted by law, the City shall not permit any part of the Water System or any facility thereof to be used or taken advantage of free of charge by any authority, firm or person, or by any public agency (including the United States of America, the State of California and any city, county, district, political subdivision, public authority or agency thereof).” Section 6.15 of the Master Installment Purchase Agreement between the City and the City’s Public Facilities Financing Authority governing sewer bonds and sewer refunding bonds provides in pertinent part: “The City will not permit any part of the Wastewater System or any facility thereof to be used or taken advantage of free of charge by any authority, firm or person, or by any public agency”

Collectively, these provisions—the Government Code statute, City Charter, municipal code provisions and the two master installment purchase agreements—require that (1) the sewer and water departments be fiscally self-sufficient and self-sustaining, (2) all users bear their share of the costs of the system (no free users), and (3) sewer and water fund revenues not exceed the cost of service. Essentially there are two requirements: sewer and water fund revenues (which include capacity charges) must be of an amount that *is at least sufficient* to cover the costs to provide the services and to make installment payments on bond obligations, *but no greater* than what is necessary to cover those costs and make those payments. Discounted capacity charges would be detrimental to the water and sewer fund revenues and unless the discounts were offset from revenue sources outside the water and sewer funds, it would not be permissible for the City to offer the discounts because of the prohibition against individual users’ capacity charges exceeding the cost of that service. *See also* City Att’y RC 2010-6 (February 4, 2010); City Att’y MOL 2007-4 (April 3, 2007); City Att’y MOL No. 96-40 (August 6, 1996).

B. Discrepancies Between the Council Policy and the Resolution

As mentioned earlier, the inaccurate cross-referencing between the Council Policy and the Resolution results in inconsistent and uncertain application. The Council Policy incorrectly cites the Resolution and the Resolution refers to and quotes from a superseded version of the Council Policy. This results in an inconsistency in the criteria for eligibility for the financial incentive and the amount of the incentive that may be offered.

The Council Policy states that the Mayor may offer the incentive of a reduction in the minimum capacity charge by \$1,000 (for a total reduction of \$2,000 for the combined sewer and water charges) and cites the Resolution, apparently as support. The Resolution, however, sets regular minimum capacity charges for water and sewer at \$2,500 each and sets reduced minimum capacity charges at *\$1,500 each*. The Resolution language specifies that the reduced capacity charge is \$1,500—not an amount that is the difference between the regular minimum charge and \$1,000, as implied by the Council Policy. Since the adoption of the Resolution in 1996, the City has modified the water and sewer capacity charges several times, generally upward. The City Council has not, however, taken any action subsequent to the Resolution to modify the *reduced* minimum capacity charges. They therefore remain at \$1,500 each.

Based on the current capacity charges, *see, supra* at 5, a business eligible for the Council Policy financial incentive would pay capacity charges that are *higher* than the actual, established discounted minimum charges. Pursuant to the Resolution, the discounted minimum capacity charges are \$1,500 each. By contrast, under the Council Policy, which permits a \$1,000 reduction, the discounted capacity charges would be \$3,124 for sewer (\$4,124 – \$1,000) and \$2,047 for water (\$3,047 – \$1,000).

The inaccurate cross-referencing between the Resolution and the Council Policy also results in uncertainty in the eligibility criteria for the financial incentives. The Resolution states that the applicable criteria are those that are set forth in the Council Policy, and then proceeds to recite those criteria. Section 1.B of the Resolution provides in pertinent part:

Notwithstanding the above [minimum water capacity charge of \$2,500 per equivalent dwelling unit], a minimum capacity charge of one thousand five hundred dollars (\$1,500) per equivalent family unit or its equivalent shall be paid for ... (3) commercial and industrial enterprises which, as determined by the City Manager, meet all of the criteria set forth in Council Policy 900-12, as follows:

- a. Contribute to the improvement and growth of the City's economic base;
- b. Demonstrate an established track record for high volume tax revenue generation;
- c. Provide employment opportunities for City residents;
- d. Demonstrate a long-term commitment to the community;
- e. Are consistent with the City's Economic Development Policy and Strategic Plan and the community's needs and objectives;
and
- f. Generate or retain stabilized annual City tax revenues of at least \$500,000, or create 200 quality jobs, or provide substantial new or expanding scientific research facilities.

Section 2.B of the Resolution is an identical provision for sewer capacity charges. These criteria, however, are from the original 1993 version of the Council Policy.

By contrast, the current version of the Council Policy states the criteria for the incentives as follows:

The City may provide assistance when necessary or appropriate to attract, retain, expand, or assist projects or businesses which meet both following criteria—

1. Either:
 - a. Provide significant revenues and/or jobs that contribute to a sound and healthy economy;
 - b. Promote the stability and growth of City taxes and other revenues;
 - c. Encourage new business and other appropriate development in older parts of the City; or
 - d. Respond to other jurisdictions' efforts to induce businesses to relocate from San Diego;

and

2. Are consistent with the City's current adopted Community and Economic Development Strategy.

Although the differences between the two versions are relatively minor, they are potentially significant. For example, the current version of the Council Policy no longer requires the applicant business to satisfy a minimum amount in tax revenue or number of jobs. For clarity's sake and in order to assure that the Council's intent is fulfilled, this office recommends the Council address these discrepancies by revising the Council Policy, the Resolution, or both. We further recommend that the Council resolve the inconsistencies regarding discounted minimum capacity charges and when they may be offered as financial assistance.

CONCLUSION

The City may properly offer discounted capacity charges for water and sewer service so long as the resulting loss in revenue to the water and sewer funds is offset with monies from outside water and sewer revenues. If the City desires to resume offering discounted capacity

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charges, it is advisable that the Council address the inconsistencies between Council Policy 900-12 and San Diego Resolution R-287543 in order to resolve ambiguities in the amount of the reduced capacity charges incentive and the eligibility criteria for that incentive.

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By _____
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