

DATE: February 10, 1987

TO: Patricia T. Frazier, Director, Financial  
Management Department  
FROM: City Attorney  
SUBJECT: Capital Outlay Fund - Investment of - Use of  
Interest Earned for Maintenance

In connection with a proposed land exchange between the City and Genstar of certain properties in the Los Penasquitos Canyon area, the City is to receive, in addition to land, approximately \$1 million. Since the \$1 million is, in effect, the proceeds from the sale of City land, the money must be deposited into the Capital Outlay Fund in accordance with Section 77 of the City's Charter. As you know, monies in the Capital Outlay Fund may only be used for permanent public improvements and specifically may not be used for "repair or maintenance" of real property.

In connection with the proposed exchange, the City Council, in approving the exchange agreement on August 12, 1985, adopted a resolution that provided that "any net income from the exchange of properties for use in Penasquitos Canyon" be retained "for use in Penasquitos Canyon for park related purposes, which purposes will be determined in the future by this City Council."

Subsequently, in connection with the City Council's discussion of the land exchange on May 20, 1986, the Council amended the resolution then before it to specify that the proceeds from the land swap "be placed in trust for the continued maintenance of Penasquitos Canyon, and any future canyon land acquisition."

This office, by memorandum dated June 16, 1986, copy attached, indicated that, because of the Charter limitations on Capital Outlay funds, the May 20, 1986, Council resolution could not authorize the use of the proceeds for maintenance. However, in August, 1986, the City Council approved a second amendment to the agreement for the land exchange which specified in part as follows:

8A.2 Use of Funds. To the extent permitted by law, City will use all funds received by it pursuant to this Agreement only for the maintenance and enhancement of the Los Penasquitos Canyon Preserve (including, but not limited to, the Genstar land). However, in no event will City use such funds, or any part thereof, to acquire lands owned by Genstar by exercise of the right of eminent domain. Nothing contained in this paragraph will be construed to preclude City, pending the

expenditure of such funds, from investing the same in City's usual and customary manner.

It has now been proposed by Mr. Richard Tartre of the City Funds Commission, in view of the City Council's expressed desire to utilize the proceeds from the exchange "to the extent permitted by law" for maintenance, that the approximately \$1 million proceeds "be invested as an endowment with the earnings used for maintenance of Los Penasquitos Canyon Preserve."

By memorandum dated January 30, 1987, you asked the following questions:

1. May the approximately \$1 million anticipated to be received from the land exchange with Genstar be invested by a contract funds manager under the supervision of the City Funds Commission with the stipulation that all earnings (interest and dividends) and/or capital appreciation be used for the maintenance of park land in Los Penasquitos Canyon Preserve?
2. Is there any condition which would have to be stipulated to ensure that the market value of the investment of the proceeds deposited into the Capital Outlay Fund from the proposed land exchange does not fall below the book value of the investment?
3. Is a Council resolution sufficient to direct that earnings from specified Capital Outlay funds be used exclusively for a particular purpose such as maintenance of Los Penasquitos Canyon Preserve?

Please see the attached memorandum of this office dated August 24, 1945, to Mr. John McQuilken, then City Auditor and Comptroller. You will note that the memorandum addressed the issue of interest earned by the Capital Outlay Fund and concluded that such interest becomes part of the Capital Outlay Fund and is subject to the use requirements contained in Charter Section 77.

Also attached are opinions of this office from 1949, 1959 and 1968 all of which address issues related to interest earned on

trust funds and all of which conclude that interest earned on trust funds become part of the trust corpus and may not be used for nontrust purposes.

As you know, one of the provisions of Section 77 provides as follows:

No moneys in said fund shall be transferred at the end of a fiscal year, but shall remain therein as trust moneys for the purposes above outlined, and the said fund shall be used and maintained, if possible, as a cash reserve to enable the City to

meet public emergencies or acquire needed permanent public improvements without the issuance of bonds.

You will note that the paragraph specifically identifies the Capital Outlay Fund as a trust fund and it is, therefore, subject to the rules and statutes applicable to trust funds including the provision referred to in the 1959 and 1968 opinions as Section 2229 of the Civil Code of the State of California, which section was recodified effective July, 1987, as Section 16004(a) of the Probate Code. The section specifies:

A trustee may not use or deal with the trust property for his own profit or for any other purpose unconnected with the trust, in any manner.

Therefore, all interest earned on Capital Outlay funds automatically becomes part of the Capital Outlay Fund and can be used only for capital outlay purposes.

In view of the answer to your first question, the issues posed in your second and third questions are, therefore, moot.

As a somewhat related matter, it is the understanding of this office that each year several million dollars of sales tax funds are budgeted to fund various capital improvement projects. If the City Council wishes, a portion of the sales tax funds could be placed into the account proposed by Mr. Tartre, and the interest used for maintenance of Penasquitos Canyon. The \$1 million from the exchange could then be used for an appropriate capital improvement project. Thus, both the desire of the Council regarding maintenance and the requirements of the Charter provisions relating to the Capital Outlay Fund could be met.

JOHN W. WITT, City Attorney

By

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Deputy City Attorney

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Attachments 5

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