

MEMORANDUM OF LAW

DATE: October 21, 1991

TO: Councilmember Abbe Wolfsheimer

FROM: City Attorney

SUBJECT: Potential Conflict of Interest Arising from an Outstanding Mortgage with Security Pacific Bank/Item S-403 on Supplemental Council Docket of October 21, 1991

By memorandum dated October 17, 1991, from your Chief of Staff Joann Johnson to Chief Deputy City Attorney Ted Bromfield you have asked the City Attorney whether you have a disqualifying conflict of interest on the proposed lease between The City of San Diego and Pacific Southwest Realty Company for City office space at Security Pacific Plaza. The matter will appear as a proposed ordinance authorizing the Manager to execute a ten (10) year lease (Item S-403(A) of the Council Docket of October 21, excerpt of Agenda attached). The matter will also appear on the Council Docket of November 4, 1991.

FACTUAL BACKGROUND

The conflict of interest question arises because you owe fifty thousand dollars (\$50,000) on a mortgage held by Security Pacific Bank for a piece of rental property in San Diego, a condominium located at 750 State Street. According to information obtained from Joann Johnson in a separate phone call, the loan (mortgage) was made to you by Security Pacific Bank at the then current market rate. It was also made to you without regard to your official status as a councilmember.

To resolve this question, it was also necessary to obtain critical facts regarding the proposed lease, the financial relationship of Pacific Southwest Realty Co. ("PSWR") and Security Pacific Bank ("Bank"), and the financial impact, if any, of the proposed lease on the Bank. Specifically, we examined City Manager's Report No. 91-443 dated October 16, 1991, on "Downtown Office Space Leases", and the proposed lease between the City and PSWR. We obtained further information by telephone from Mr. Stephen Karas, Vice-President of PSWR, and Mr. John Donovan of Donovan/Irving Group Inc., the City's consultant for office space leasing.

We learned that PSWR is a wholly owned subsidiary of the Bank. PSWR essentially acts as a holding company for real property interests held by the Bank. PSWR is also the master lessee of the property known as Security Pacific Plaza. The actual owner of Security Pacific Plaza is the Estate of Edwin S. Lowe. The term of the proposed lease is ten (10)

years. Assuming there is no expansion, the anticipated revenues to PSWR from the lease over the ten (10) year period will be approximately twenty million dollars (\$20,000,000). Assuming there is expansion, which the proposed lease expressly contemplates, the anticipated revenues to PSWR will exceed that amount. Some of these revenues will eventually go to the Bank as owner of PSWR. Additionally, the Bank itself, not simply its subsidiary PSWR, may reasonably foreseeably have reduced expenses annually in an amount exceeding two hundred fifty thousand dollars (\$250,000) resulting from the lease between the City and PSWR. Also relevant to this inquiry are the facts that Security Pacific Bank is listed on the New York Stock Exchange and is among the 500 largest non-industrial corporations in the United States.

ANALYSIS

Conflict of interest questions arise primarily under the Political Reform Act of 1974 (Government Code section 81000 et seq.). The Act specifies when economic conflicts prohibit a public official from participating in or making a governmental decision, as follows:

Section 87100. Public Officials; State and Local.

No public official at any level or state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest.

The term "financial interest" is defined in Government Code section 87103. This section reads as follows:

Section 87103. Financial Interest.

An official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official or a member of his or her immediate family or on:

(a) Any business entity in which the public official has a direct or indirect investment worth one thousand dollars (\$1,000) or more.

(b) Any real property in which the public official has a direct or indirect interest worth one thousand dollars (\$1,000) or more.

(c) Any source of income, other than gifts and other than loans by a commercial lending institution in the regular course of business on terms available to the public without regard to official status, aggregating two hundred fifty dollars (\$250) or more in value provided to, received by, or promised to the public official within 12 months prior to the time when the decision is made.

(d) Any business entity in which the public official is a director, officer, partner, trustee, employee, or holds any position of management.

(e) Any donor of, or any intermediary or agent for a donor of, a gift or gifts aggregating two hundred fifty dollars (\$250) or more in value provided to, received by, or promised to the public official within 12 months prior to the time when the decision is made.

For purposes of this section, indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official, by an agent on behalf of a public official, or by a business entity or trust in which the official, the official's agents, spouse, and dependent children own directly, indirectly, or beneficially a 10-percent interest or greater.

Generally, the term "financial interest" falls into one of three categories: real property, investment or income.

1. Does the mortgage constitute an "income interest"?

The first issue presented by the current facts is whether the mortgage of fifty thousand dollars (\$50,000) held by Security Pacific Bank on the State Street property constitutes an income interest within the meaning of the Act.F

Under the present facts, you have no "investment interest" within the meaning of the Act, but you clearly have a "real property interest" in the condominium on State Street. You also have an "income interest" in that condominium, because you are receiving rental income from that property. These economic interests, however, are not relevant here.

We think it does, for the following reasons.

The term "income" is defined in Government Code section 82030 and includes, among other things, payments received in the form of loans. Loans from commercial lending institutions are expressly excluded from the definition of income if certain criteria are met. The relevant language reads as follows:

(b) "Income" also does not include:

....

(8) Any loan or loans from a commercial lending institution which are made in the lender's regular course of business on terms available to members of the public without regard to official state if:

(A) Used to purchase, refinance the purchase of, or for improvements to, the principal residence of filer, or

(B) The balance owed does not exceed ten thousand dollars (\$10,000).

Under this Government Code section, mortgage loans made to purchase or refinance personal residences do not count as income (if the loan was made at market rate and was made without regard to the official's status). However, mortgage loans made to purchase or refinance other types of real property, such as rental property, do count as income if the loan balance exceeds ten thousand dollars (\$10,000) (even if the loan was made at market rate and without regard to the official's status).

Under the present facts, you own property at 750 State Street in San Diego, which you do not use as your residence but which you rent to someone else. You have a fifty thousand dollar (\$50,000) mortgage on that property; the mortgage is held by Security Pacific Bank. The mortgage was made at the then current market rate and it was obtained without regard to your official status as Councilmember. Since the balance on the mortgage exceeds ten thousand dollars (\$10,000) and covers rental property, not your personal residence, the mortgage counts as income to you. Therefore, Security Pacific Bank is a source of income to you within the meaning of Government Code Section 87103.

2. Will there be a material financial effect on the Bank?

Having determined that the fifty thousand dollars (\$50,000) mortgage constitutes income and also that the Bank is a source of income to you by virtue of the mortgage, the next question to be decided is whether the Council's vote on the proposed lease will materially financially affect the Bank.

There is no doubt that the Council's discussion and vote on the ordinance approving the lease is in the nature of a governmental decision within the meaning of the Act. Therefore, the analysis moves straight to the "materiality" issue.

Whether a governmental decision will have a "material" financial effect on a source of income is determined under regulations adopted by the Fair Political Practices Commission ("FPPC"). These are located at Title 2, Division 6 of the California Code of Regulations (section 18110 et seq.). The applicable regulation in the present case is 2 Cal. Code of Regs. section 18702.2, which reads in relevant part as follows:

18702.2. Material Financial Effect: Business

Entity Indirectly Involved in the Decision

The effect of a decision is material as to a business entity in which an official has an economic interest if any of the following applies:

(a) For any business entity listed on the New York Stock Exchange or the American Stock Exchange:

(1) The decision will result in an increase or decrease to the gross revenues for a fiscal year of \$250,000 or more, except in the case of any business entity listed in the most recently published fortune Magazine directory of the 500 largest U.S. industrial

corporations or the 500 largest U.S. nonindustrial corporations, in which case the increase or decrease in gross revenues must be \$1,000,000 or more; or

(2) The decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$100,000 or more, except in the case of any business entity listed in the most recently published Fortune Magazine Directory of the 500 largest U.S. industrial corporations or the 500 largest U.S. nonindustrial corporations, in which case the increase or decrease in expenditures must be \$250,000 or more; or

(3) The decision will result in an increase or decrease in the value of assets or liabilities of \$250,000 or more, except in the case of any business entity listed in the most recently published Fortune Magazine Directory of the 500 largest U.S. industrial corporations or the 500 largest U.S. nonindustrial corporations, in which case the increase or decrease in assets or liabilities must be \$1,000,000 or more. Emphasis added.

Given the short time in which we had to gather relevant facts to render this opinion, we were able to find facts only to make a determination under Subsection (a)(2) of the above-quoted regulation. However, since the facts we obtained are sufficient to make a dispositive determination of the issue of materiality, there is no need to make further factual inquiry to determine whether the criteria under subsection (a)(1) and (a)(3) are also met.

Under Regulation 18702.2(a)(2), the relevant questions for purposes of determining the conflict of interest issue in the present case are: 1) whether the business entity that is a source of income to an official is listed on the New York Stock Exchange; 2) whether the business entity is among the 500 largest U.S. nonindustrial corporations; and, 3) whether the governmental decision will result in increasing or decreasing the business entity's expenses in a fiscal year by two hundred fifty thousand dollars (\$250,000) or more.

As stated above, we obtained answers to these factual questions from Messieurs Steve Karas and John Donovan. We learned that Security Pacific Bank is listed on the New York Stock Exchange and is among the 500 largest nonindustrial companies in the United States. They also determined that, although not absolutely certain, it is reasonably

foreseeable that the Bank itself, not simply its subsidiary PSWR, would have its existing expenses decreased by two hundred fifty thousand dollars (\$250,000) or more per fiscal year because of the lease. Therefore, since all of the criteria of Regulation 18702.2(a)(2) are met, we conclude that the Council's decision to approve the lease with PSWR will result in a material financial effect on the Bank.

The ultimate conclusion we reach is that you have a potential conflict of interest in the proposed lease between the City and PSWR for office space in Security Pacific Plaza. The conflict arises because you have an outstanding balance of over ten thousand dollars (\$10,000) in a mortgage held by Security Pacific Bank for some rental property you own in San Diego. Therefore, unless you come within the "public generally" exception, discussed below, you should refrain from participating in or voting on Item 403(A) on the October 21 docket.

3. Does the "Public Generally" Exception Apply to these Facts?

Having decided the Council's decision to approve or disapprove the proposed lease will reasonably foreseeably result in a material financial effect on one of your economic interests, Security Pacific Bank, you may still be eligible to participate and vote on the lease if it can be shown that the public generally will be affected in substantially the same way.

The relevant portion of FPPC regulation section 18703 defining the phrase "public generally" is set forth below. Whether the "public generally" exception applies will generally turn on the particular facts of a given situation.

18703. Effect on the Public Generally

A material financial effect of a governmental decision on an official's interests, as described in Government Code Section 87103, is distinguishable from its effect on the public generally unless the decision will affect the official's interest in substantially the same manner as it will affect all members of the public or a significant segment of the public. Except as provided herein, an industry, trade or profession does not constitute a significant segment of the general public. *Emphasis added.*

2 Cal. Code of Regs. section 18703.

Although the FPPC has never adopted a strict arithmetic test for determining what constitutes a significant segment of the public, the FPPC has stated that the population affected be large in number and heterogeneous in nature.

We have advised in the past that 36 percent of the housing units and population of a county constituted a significant segment of the public. (Marsh Advice Letter, No. I-90-151) We have advised that the 25 percent of a city's population served by a new bridge was a significant segment of the population. (Christensen

Advice Letter, No. A-89-422) We have also advised that two percent of the similarly situated homeowners and one percent of the population of a city's population are not a significant segment of the public. (Remelmeyer Advice Letter, No. 87-210; Zamboni Advice Letter, No. A-89-021) The residential units in a development zone constituting five percent of the residences in a city are not a significant segment of the population. (Cosgrove Advice Letter, No. A-89-120) We have also said that 15 land owners out of the entire city of Carlsbad was not a significant segment of the population of Carlsbad. (Biondo Advice Letter, No. I-90-241)

Although it is not absolutely clear under the statute or regulations who the relevant "public" is for purposes of determining whether the "public generally" exception applies in the present case, we believe that determining a bank's market share of the regional retail loan market would be a viable measure of the relevant public. Therefore, we asked Mr. Karas of PSWR to supply us with further information on that subject. By telephone on October 21, we learned from Mr. Karas that Security Pacific is in twenty-fifth place among regional lending institutions in the retail loan market and has funded 9.5% of the retail loans in San Diego County. Given this percentage, we cannot say that this constitutes a significant segment of the public permitting your participation.

CONCLUSION

You have a potential conflict of interest in the proposed lease between the City and PSWR for office space in Security Pacific Plaza. The conflict arises because you have an outstanding balance of over ten thousand dollars (\$10,000) in a mortgage held by Security Pacific Bank for some rental property you own in San Diego. In light of the guidance provided by several FPPC private advice letters, we cannot assuredly say that 9.5% of the retail loan market constitutes a significant segment of the public for purposes of qualifying for the public generally exception. Therefore, out of an abundance of caution, we advise you to refrain from participating or voting on the proposed lease between the City and PSWR (Item 403(A) on October 21 docket).

JOHN W. WITT, City Attorney

By

Cristie C. McGuire

Deputy City Attorney

CCM:jrl:011(x043.2)

Attachment

ML-91-82