Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 533-5800

DATE: December 8, 2011

TO: Mayor and City Council

FROM: City Attorney

SUBJECT: County of San Diego's Use of Centre City Tax-Sharing Funds

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INTRODUCTION

Recently, the City Council of the City of San Diego (Council) approved that certain "Five-Year Work Plan Toward the Goal of Ending Homelessness in Downtown San Diego" covering the period from July 1, 2011, through June 30, 2016 (Work Plan). Before voting to approve the Work Plan, several Councilmembers inquired about the level of participation by the County of San Diego (County) in furthering the effort to end downtown homelessness.

In particular, Councilmember DeMaio asked whether the Redevelopment Agency of the City of San Diego (Agency) or the City of San Diego (City) could compel or otherwise arrange for the County to "re-program" or use any portion of certain tax-sharing funds derived from the Centre City Redevelopment Project Area (Project Area) to address downtown homelessness.

QUESTIONS PRESENTED

1. Can the County be compelled to use a portion of contractual tax-sharing funds derived from the Project Area toward the goal of ending downtown homelessness?

2. If not, can any alternative method be employed to attempt to persuade the County to use such tax-sharing funds toward the goal of ending downtown homelessness?

SHORT ANSWERS

1. No. Under the operative tax-sharing agreement, the County retains the ultimate discretion concerning how the contractual tax-sharing funds are expended so long as at least forty percent of the funds are expended for particular eligible uses.

2. Yes. The operative tax-sharing agreement provides that the County must reasonably consider the Agency's proposals for expenditure of the tax-sharing funds toward particular eligible uses and, at the Agency's request, must participate in a progress meeting to discuss specific proposals. In addition, the Agency and the County could mutually agree to amend the existing agreement to provide for the County's expenditure of the tax-sharing funds in a particular way on a going-forward basis.[1]

BACKGROUND

A. Source and Use of Tax Increment Revenue.

Redevelopment agencies (RDAs) rely primarily on tax increment revenue to finance their operations and activities under the California Community Redevelopment Law, set forth at California Health and Safety Code sections 33000-33855 (Community Redevelopment Law). Tax increment revenue is calculated based on the incremental increase in the assessed value of real property within a redevelopment project area. The incremental increase is measured in comparison to the base property tax assessment as of the effective date of the ordinance adopting a redevelopment plan to create a new redevelopment project area or amending the plan to expand the territory of the redevelopment project area. Cal. Health & Safety Code §§ 33670, 33678. During the life of the redevelopment plan, the growth in property tax revenues within the redevelopment project area, accrued in excess of the base property tax assessment, is allocated to the RDA as tax increment revenue. Other local taxing agencies, such as the local city and county, the local school districts, and the local community college districts, continue to receive the same amount of property tax revenues they received before the effective date of the applicable ordinance, but none of the growth in property tax revenues (with the exception of certain tax-sharing payments made by the RDA, as described below).

Each RDA must use its tax increment revenue "to pay the principal of and interest on loans, moneys advanced to, or indebtedness . . . incurred by the [RDA] to finance or refinance, in whole or in part, the redevelopment project." Cal. Health & Safety Code § 33670(b); Cal. Const. art. XVI, § 16. Further, each RDA must expend its tax increment revenue for "redevelopment activity" only. Cal. Health & Safety Code § 33678(a)-(b). The Community Redevelopment Law defines "redevelopment" to include various types of activities aimed at eliminating or reducing physical and economic blight. Cal. Health & Safety Code §§ 33020, 33021, 33031. Those redevelopment activities commonly include the financing of capital improvements, affordable housing, and real estate acquisitions.

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[1] As a general rule, the Agency is not presently allowed to execute new agreements or amend existing agreements in light of an amended order issued by the California Supreme Court on August 17, 2011. The amended order is expected to remain in effect until the California Supreme Court issues its final written opinion in the pending litigation challenging the validity of new legislation that seeks to eliminate all redevelopment agencies in California, but allows them to continue their operations in exchange for the annual payment of substantial amounts for the benefit of the State of California. It is likely that the final written opinion will be issued by mid-January 2012. While we cannot predict the outcome of the litigation, this Report assumes, for the sake of discussion, that the prohibitions in the amended order will no longer apply once the litigation has been resolved on its merits.

B. Major Shift in Statutory Basis for Tax-Sharing Payments.

RDAs have historically shared a portion of their tax increment revenue by making so-called "tax-sharing payments" or "pass-through payments" to other local taxing agencies. The tax-sharing payments partially mitigate the loss of growth in property tax revenues received by other local taxing agencies after the creation or expansion of a redevelopment project area. As discussed below, the legal basis for the tax-sharing payments has evolved from a negotiated contractual arrangement during the pre-1994 era to a prescribed statutory formula thereafter.

Prior to 1994, whenever an RDA sought to create or expand a redevelopment project area, the RDA typically negotiated a tax-sharing agreement with each local taxing agency, by which the RDA agreed to share a portion of its tax increment revenue with such taxing agencies. Under pre-1994 law, each RDA was authorized to pay to any local taxing agency "any amounts of money which the [RDA] has found are necessary and appropriate to alleviate any financial burden or detriment caused to any taxing agency by a redevelopment project." Former Cal. Health & Safety Code § 33401(b).

In 1993, the California Legislature enacted Assembly Bill 1290 (AB 1290), also known as the Community Redevelopment Law Reform Act, which eliminated the authority of RDAs to negotiate pass-through agreements with local taxing agencies. AB 1290 provides that, effective as of January 1, 1994, if an RDA adopts a redevelopment plan creating a new redevelopment project area or amends an existing redevelopment plan to add territory to a redevelopment project area, the RDA must make specified payments to affected local taxing agencies throughout the life of the redevelopment plan. Cal. Health & Safety Code § 33607.5. In other words, as a result of AB 1290, tax-sharing payments by RDAs are now mandated by statutory formula rather than dependent upon contractual negotiations. This statutory formula increases the pass-through share allocated to local taxing agencies in incremental stages over the life of the redevelopment plan.

By approving AB 1290, the California Legislature mainly intended to prevent RDAs from negotiating significant tax-sharing payments to other local taxing agencies in exchange for their agreement not to oppose the creation or expansion of unduly large redevelopment project areas that may not be actually blighted. The California Legislature believed that AB 1290 would help to preserve the flow of property tax revenues into the State of California's general fund and to minimize the amount of such revenues allocated to RDAs in the form of tax increment. Assembly Bill 1424, Cal. Stats. 1995, ch. 141 § 1. By the same token, AB 1290 has reduced the incentive of local taxing agencies to threaten litigation in an effort to extract additional tax-sharing payments from RDAs. AB 1290 provides that, as of January 1, 1994, an RDA cannot be compelled to make any tax-sharing payments in excess of the statutory pass-through payments, which are the exclusive payments required to be made by the RDA to local taxing agencies during the life of a redevelopment plan. Cal. Health & Safety Code § 33607.5(f)(1)(B), (2).

C. Amended Tax-Sharing Agreement between the Agency and the County.

In 1992, before the enactment of AB 1290, the Council adopted an ordinance that formed the Project Area, comprised of the merger of three then-existing redevelopment project sub areas,

known as the Columbia, Marina, and Gaslamp Quarter Sub Areas, as well as the expansion of additional territory into the Expansion Sub Area. San Diego Ordinance No. O-17767 (May 11, 1992). In anticipation of that ordinance, the Agency and the County entered into that certain Agreement for Cooperation between Redevelopment Agency of the City of San Diego and the County of San Diego dated May 5, 1992 (Original Tax-Sharing Agreement).[2] Redevelopment Agency Doc. No. 1911 (May 22, 1992). The Agency and the County later amended the Original Tax-Sharing Agreement through that certain First Implementation Agreement thereto dated June 29, 1993 (First Implementation Agreement) and that certain Second Implementation Agreement thereto dated August 9, 1994 (Second Implementation Agreement). Redevelopment Agency Doc. No. D-2053 (Aug. 23, 1993); Redevelopment Agency Doc. No. 2161 (Sep. 14, 1994).

The Original Tax-Sharing Agreement, as amended by the First Implementation Agreement and the Second Implementation Agreement (collectively, Amended Tax-Sharing Agreement), recognizes that it is appropriate for the Agency to make tax-sharing payments to the County to alleviate the financial burden or detriment caused to the County by the formation of the Project Area. Under the Amended Tax-Sharing Agreement, the Agency is required to make tax-sharing payments to the County on an annual basis commencing in Fiscal Year 1992-93 and continuing until the Agency's right to receive tax increment revenue (defined therein as "Property Tax Revenues") derived from the Project Area is terminated or expires. The tax-sharing payments are calculated as a percentage of the Agency's tax increment revenue derived from the Project Area; that percentage increases in specified increments as certain monetary thresholds are met in the Agency's annual collection of tax increment revenue.[3] Original Tax-Sharing Agreement § 3.1. The eligible purposes for which the County may expend the tax-sharing funds are described in detail below.

ANALYSIS

I. THE COUNTY CANNOT BE LEGALLY COMPELLED TO USE CENTRE CITY TAX-SHARING FUNDS TO ADDRESS DOWNTOWN HOMELESSNESS

The Amended Tax-Sharing Agreement establishes two categories of tax-sharing funds and describes how the County may use such funds. Under the first category, the County must use at least forty percent of the Agency's tax-sharing payments attributable to the Project Area (Restricted Funds) solely to pay for eligible expenditures on certain facilities and programs

[2] The Agency entered into similar tax-sharing agreements with other local taxing agencies during the same time frame. Those agreements remain in effect, but are outside the scope of this Report.

[3] The percentage of tax increment revenue to be paid by the Agency to the County equals: (i) 0.75 percent beginning in Fiscal Year 1992-93; (ii) 5 percent beginning in the first fiscal year after the Agency's tax increment revenue from the Project Area reaches $15 million; (iii) 7 percent beginning in the first fiscal year after the Agency's tax increment revenue from the Project Area reaches $27 million; and (iv) subject to a limited exception, 14.7 percent beginning in the first fiscal year after the Agency's tax increment revenue from the Project Area reaches $114 million and the Agency's cumulative tax increment revenue attributable to the Columbia, Marina, and Gaslamp Quarter Sub Areas reaches $630 million. Based on the Agency's prior tax increment revenue in the Project Area, the County will receive the highest contractual pass-through share (i.e., 14.7 percent) of the Agency's annual tax increment revenue derived from the Project Area during the current fiscal year and continuing throughout the life of the Project Area.

located within the Project Area or directly serving the residents and employees of the Project Area and the immediate vicinity (Eligible Uses). Under the second category, comprising the balance of tax-sharing payments in excess of the forty percent minimum threshold (Unrestricted Funds), the County is permitted to either maintain the Unrestricted Funds in an earmarked account and expend them for redevelopment purposes or transfer the Unrestricted Funds to the County's general fund and expend them for any purpose, or a combination of both. Original Tax-Sharing Agreement § 3.3. Thus, the Agency has no contractual right to compel the County to expend the Unrestricted Funds for a specific purpose.

As to expenditure of the Restricted Funds, the Eligible Uses include the acquisition of land and the provision of equipment for, and the construction, reconstruction, rehabilitation, and maintenance of, justice, health, social, and other facilities, and the provision of justice, health, social, and other programs. Representative examples of the Eligible Uses include facilities and programs related to: (i) courtrooms and justice; (ii) counseling, education, and training for persons convicted of misdemeanors and light felonies; (iii) mental health treatment; (iv) alcohol and drug rehabilitation; (v) children's services; and (vi) health and welfare services. Original Tax-Sharing Agreement § 3.3. The Amended Tax-Sharing Agreement describes three levels of priority in the expenditure of Restricted Funds. The highest priority is given to facilities and programs referred to in the Redevelopment Plan for the Project Area and any new facilities and programs needed within the Project Area. Second priority is given to facilities and programs directly serving the residents and employees of the Project Area as referred to in earlier documents, including a staff report and a final environmental impact report. Third priority is given to additional justice, health, social, and other facilities that meet the criteria set forth in Section 3.3 of the Original Tax-Sharing Agreement.[4] Original Tax-Sharing Agreement § 3.3.

The Amended Tax-Sharing Agreement also sets forth procedures for the County's deposit and expenditure of the Restricted Funds. The County must deposit all of the tax-sharing payments derived from the Project Area, including both the Restricted Funds and the Unrestricted Funds, into an earmarked account (designated as the "County Fund") and must provide the Agency with an annual written report describing the County's expenditure of the Restricted Funds during the preceding fiscal year. Original Tax-Sharing Agreement § 3.2. At least thirty days before committing any Restricted Funds to a specific purpose, the County must deliver written notice to the Agency concerning the proposed expenditure on certain facilities or programs and must allow the Agency to review and comment on the proposed expenditure. The Agency retains the right, at any time, to propose specific facilities and programs to be financed with any of the tax-sharing payments. While the County must "reasonably consider" the Agency's proposals, the County retains "the ultimate discretion in the expenditure of the monies, and the selection of projects."[5] Original Tax-Sharing Agreement § 3.3.

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[4] The Amended Tax-Sharing Agreement is not drafted with precision, and is thus susceptible to conflicting interpretation, on the topic of relative priority of facilities and programs to be financed by the Restricted Funds. The above description of the relative priority constitutes what we consider to be the most reasonable interpretation.

[5] The Amended Tax-Sharing Agreement contains several special provisions related to the financing of downtown court facilities. During a thirty-year period commencing in Fiscal Year 1992-93 and continuing through Fiscal Year 2021-22, if the County's annual receipt of tax-sharing payments is less than $800,000, then the Agency must make a supplemental tax-sharing payment in an amount that ensures the County's collection of $800,000 during such fiscal year. Second Implementation Agreement § 3.1. During such thirty-year period, the County must deposit the first

Based on the above discussion, the Amended Tax-Sharing Agreement allows the Agency to make suggestions as to how the County should expend the tax-sharing funds, including both the Restricted Funds and the Unrestricted Funds, but confers the County with the final discretion to decide how the funds are actually expended. The only contractual limitation is that the County must expend the Restricted Funds for one or more of the Eligible Uses. We are aware that objections have been raised with respect to the County's priorities in its prior expenditure of the tax-sharing funds.[6] Yet, the Amended Tax-Sharing Agreement does not provide the Agency with any remedy to compel the County to use any portion of the Restricted Funds for a particular Eligible Use or any portion of the Unrestricted Funds for a specific purpose, such as facilities and programs providing health and welfare services.

Further, the City is not a signatory to the Amended Tax-Sharing Agreement, which is the legal document exclusively governing the County's receipt and expenditure of the Agency's tax-sharing payments. Original Tax-Sharing Agreement § 4.4. In any event, the City, like the Agency, has no ability to compel the County to expend the Restricted Funds for a particular Eligible Use or the Unrestricted Funds for a specific purpose.

II. THE AGENCY CAN RELY UPON EXISTING CONTRACTUAL PROVISIONS TO TRY TO NEGOTIATE THE COUNTY'S USE OF TAX-SHARING FUNDS TOWARD THE GOAL OF ENDING DOWNTOWN HOMELESSNESS

A. The County Must Reasonably Consider any Proposal for Expenditure of Tax-Sharing Funds Toward any Eligible Uses.

While the Agency cannot compel the County to expend the tax-sharing funds for a specific purpose selected unilaterally by the Agency, the Amended Tax-Sharing Agreement contains at least three provisions that may be justifiably viewed as requiring the County to cooperate in good faith with the Agency regarding expenditure of the tax-sharing funds. First, as noted above, the County must "reasonably consider" the Agency's proposals for expenditure of the tax-sharing funds on particular facilities and programs, even though the County retains the "ultimate discretion" as to how the funds are expended. Original Tax-Sharing Agreement § 3.3. It is unclear exactly what is encompassed within the County's contractual obligation to "reasonably consider" the Agency's proposals. At a minimum, however, that obligation should prevent the

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$800,000 of annual tax-sharing payments into a designated "Court Payment Account" of the County Fund. Second Implementation Agreement § 3.1. The County must use the funds in the Court Payment Account only toward the capital costs of constructing the court/office building in the Project Area at the site bounded by Broadway, State, Union, and C Streets. First Implementation Agreement § 3.3; Second Implementation Agreement §§ 3.2, 4. Moreover, as required by contract, the Agency made an additional, one-time tax-sharing payment to the County in 1994 in the amount of $1,200,000, to be used by the County solely to pay for project costs related to the installation of eight additional courtrooms within the downtown court facilities. Second Implementation Agreement § 4.

[6] At the time of approval of the Work Plan, both Councilmembers and members of the public expressed a desire for the County to expend a meaningful amount of the tax-sharing funds directly toward the goal of ending downtown homelessness, such as social service programs or homeless shelters. So far, the County has expended a substantial portion of the tax-sharing funds toward the construction and financing of downtown court facilities (i.e., the Hall of Justice). The County also recently communicated its intent to expend over $5.1 million of the Restricted Funds toward the development and construction of a waterfront park, which could be regarded as a social facility or other, similar facility within the meaning of the Amended Tax-Sharing Agreement.

County from dismissing the Agency's proposals without careful consideration of the rationale behind those proposals and the County's own financial priorities for facilities and programs. Second, the Amended Tax-Sharing Agreement requires the parties to "reasonably cooperate" in an effort to formulate and implement financing devices to promote the effective use of the tax-sharing payments for the contemplated purposes. Original Tax-Sharing Agreement § 3.4. Third, the Amended Tax-Sharing Agreement requires the parties to hold periodic meetings to discuss their progress in implementing the Amended Tax-Sharing Agreement, to the extent such meetings are requested by either the County's Chief Administrative Officer or the Agency's Executive Director. Original Tax-Sharing Agreement § 4.3.

Relying upon the above-described provisions in the Amended Tax-Sharing Agreement, the Agency could request a meeting with the County to discuss any specific proposal by the Agency for the County to expend all or any portion of the tax-sharing payments, including the Restricted Funds, toward particular facilities and programs. If the County agrees with the Agency's specific proposal to expend a portion of the tax-sharing funds toward social service programs benefitting the homeless population in the Project Area, then the County could allocate tax-sharing funds for that purpose. For example, the Centre City Development Corporation, Inc., acting on the Agency's behalf, delivered a written proposal in December 2010, asking the County to make a significant financial contribution toward the future operating costs that will arise after the World Trade Center office building in the Project Area has been rehabilitated and converted into a one-stop housing and services center for the local homeless population. So far, the County has not agreed to contribute any funds toward the World Trade Center project.

B. The Agency and the County Could Mutually Agree to Modify the Existing Arrangement for the County's Use of Tax-Sharing Funds.

We have not found any legal precedent determining the issue of whether parties to a pre-AB 1290 tax-sharing agreement are authorized to amend such agreement after AB 1290 became effective on January 1, 1994. Therefore, we believe a reasonable conclusion is that post-AB 1290 amendments to an existing tax-sharing agreement are legally permissible, at least where such amendments do not plainly frustrate the main purpose of AB 1290 – to prevent the creation or expansion of unduly large redevelopment project areas.

AB 1290 provides that, despite the complete ban on any new negotiated tax-sharing agreements on or after January 1, 1994, the AB 1290 amendments "shall not be deemed or construed to invalidate, impair, or otherwise affect" tax-sharing agreements entered into prior to January 1, 1994. Cal. Stats. 1993, ch. 942 § 38(b). The California Legislature, then, intentionally exempted preexisting contractual tax-sharing arrangements from the limitations of AB 1290. There is no language in AB 1290 suggesting that the California Legislature intended to abolish the inherent right of parties to amend a preexisting contract in the context of tax-sharing arrangements, particularly where the contract already envisioned potential future amendments.

In this instance, the Amended Tax-Sharing Agreement provides that amendments are permitted by written agreement of the parties. Original Tax-Sharing Agreement § 4.4. Moreover, our research indicates that several different RDAs in California have executed amendments to tax-

sharing agreements after the effective date of AB 1290, apparently without legal challenge. Indeed, the Second Implementation Agreement constitutes a post-AB 1290 amendment to the Amended Tax-Sharing Agreement.

In sum, it is possible that the Agency and the County could modify the Amended Tax-Sharing Agreement to obligate the County, on a going-forward basis, to expend a minimum amount or percentage of the Restricted Funds for a particular Eligible Use or the Unrestricted Funds for a specific purpose. Any such modification, however, would require the approval of both the Agency's Board of Directors and the County Board of Supervisors in their respective sole discretion. It is uncertain whether the County would agree, absent any contractual requirement, to alter the current provisions governing the County's future expenditure of the tax-sharing funds.

C. The County Is Legally Permitted to Use the Tax-Sharing Funds for any Valid Governmental Purpose, Subject to any Applicable Contractual Restrictions.

Finally, in response to a public comment raised before the Council's approval of the Work Plan, we wish to point out that a significant distinction exists between the Agency's use of tax increment revenue and the County's use of tax-sharing funds received from the Agency.

The Community Redevelopment Law requires RDAs to expend their tax increment revenue for "redevelopment activity" only. Cal. Health & Safety Code § 33678(a)-(b). With respect to the instant situation, the Agency generally can use its funds for construction and rehabilitation of physical facilities serving the homeless population, but not for social service programs and operations of homeless shelters. MS-2010-5 (May 21, 2010).

By contrast, contractual tax-sharing payments received by a local taxing agency, such as the payments to the County under the Amended Tax-Sharing Agreement, are treated as general property taxes and are not subject to the strict limitations imposed on RDAs by the Community Redevelopment Law. *See White v. State of California*, 88 Cal. App. 4th 298, 311 (2001) (redevelopment funds legislatively allocated from RDA to local county as part of Orange County's bankruptcy plan constituted general property tax, not special tax). The County can use general property tax, such as contractual tax-sharing funds, for any valid governmental purpose.[7] *Howard Jarvis Taxpayers Ass'n v. City of Roseville*, 106 Cal. App. 4th 1178, 1185 (2003). An exception to this general rule occurs where the County has agreed by contract to restrict its use of tax-sharing funds in a particular manner. As mentioned above, the Amended Tax-Sharing Agreement requires the County to use the Restricted Funds for one or more of the Eligible Uses, but allows the County to use the Unrestricted Funds for any redevelopment purpose or to transfer

[7] A local taxing agency's use of statutory pass-through payments received from any RDA after the passage of AB 1290 is arguably more limited than its use of contractual tax-sharing payments. Upon creating the current statutory pass-through scheme, the State Legislature expressed its intent that the statutory pass-through payments "will benefit redevelopment project areas." Cal. Health & Safety Code § 33607.5(f)(1)(A). In that regard, local education agencies receiving statutory pass-through payments under AB 1290 generally must expend those funds toward schools within or benefitting the redevelopment project area from which the property taxes have been generated. Cal. Health & Safety Code § 33607.5(a)(5).

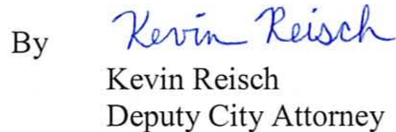
the Unrestricted Funds to the County's general fund and expend them for any valid governmental purpose. Original Tax-Sharing Agreement § 3.3.

CONCLUSION

Under the Amended Tax-Sharing Agreement, the Agency may propose specific ways in which the County could expend the tax-sharing funds, but the County retains the ultimate discretion as to how those funds are expended so long as the Restricted Funds are expended toward one or more of the Eligible Uses. The City does not have any contractual rights with respect to the County's expenditure of the tax-sharing funds.

The Amended Tax-Sharing Agreement provides that the County must reasonably consider the Agency's proposals for expenditure of the tax-sharing funds. The Agency could schedule a progress meeting with the County to discuss the Agency's specific proposals. In addition, the Agency and the County could mutually agree to modify the Amended Tax-Sharing Agreement to provide for the County's expenditure of the tax-sharing funds in a particular way on a going-forward basis.

JAN I. GOLDSMITH, CITY ATTORNEY

By 

Kevin Reisch
Deputy City Attorney

KR:nja

cc: Jay M. Goldstone, Chief Financial Officer
Janice L. Weinrick, Assistant Director, Redevelopment Department
Andrea Tevlin, Independent Budget Analyst

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