

**Office of
The City Attorney
City of San Diego**

**MEMORANDUM
MS 59**

(619) 533-5800

DATE: February 19, 2015
TO: Honorable Mayor and City Councilmembers
FROM: City Attorney
SUBJECT: Proposed Renewal of Downtown Property and Business Improvement District

INTRODUCTION

The existing Downtown Property and Business Improvement District (Downtown PBID), administered by the Downtown San Diego Partnership, will expire on June 30, 2015. The City Council will hold the first of two hearings on February 24, 2015, regarding the proposed ten-year renewal of the Downtown PBID. At the first hearing, the City Council will be asked to initiate the renewal process by adopting a Resolution of Intention to levy and assess, as identified in the Management District Plan/Engineer's Report, July 2015-June 2025 (District Plan). At the second hearing, presently scheduled for May 11, 2015, the City Council will be asked to authorize renewal of the Downtown PBID by adopting a Resolution of Formation.

This memorandum provides a broad overview of the legal and financial risks under the Property and Business Improvement District Law of 1994, California Streets and Highways Code sections 36600-36671 (PBID Law) and other relevant law associated with renewing the Downtown PBID as currently proposed. These risks are discussed in further detail in a confidential memorandum.

Over the past several months, this Office has coordinated extensively with the preparers of the District Plan – including Bennett Engineering, Inc. (Engineer) and Civitas (Consultant) – to resolve numerous flaws that this Office identified in the early iterations of the District Plan. While the Engineer and the Consultant have made substantial changes to the District Plan that will improve its legal defensibility in the event of a future lawsuit, the renewal of the Downtown PBID is still subject to legal and financial risks that are difficult to quantify at this time.

BACKGROUND

I. GOVERNING STATUTORY AND CONSTITUTIONAL AUTHORITY

Each Property and Business Improvement District (PBID) is governed by PBID Law and is formed to “promote the economic revitalization and physical maintenance of business districts [of its cities] in order to create jobs, attract new businesses, and prevent the erosion of the business districts.” Cal. Sts. & High. Code § 36601(b). Under PBID Law, liability for the assessment may be premised upon either ownership of real property or operation of a business within the district. In the City’s sole PBID, the Downtown PBID, liability for the assessment is premised upon ownership of real property within the district.

The Downtown PBID is governed by Proposition 218 because the responsibility to pay the assessment is connected to ownership of real property.¹ Cal. Const. art. XIII D, § 2(b). Proposition 218 defines an assessment as “any levy or charge upon real property by an agency for a special benefit conferred upon the real property.” *Id.* Proposition 218 restricts a public agency’s ability to impose assessments by requiring the agency to make findings of both a special benefit and proportionality to support an assessment. An assessment can be imposed *only* for a special benefit conferred on a particular property. *Id.* §§ 2(b), 4(a). A special benefit is “a particular and distinct benefit over and above general benefits conferred on real property located in the district or to the public at large.” *Id.* § 2(i). In addition, the amount of an assessment on any given parcel must be in proportion to the special benefit conferred on that parcel. *Id.* § 4(a). “The proportionate special benefit derived by each identified parcel shall be determined in relationship to the entirety of the capital cost of a public improvement, the maintenance and operation expenses of a public improvement, or the cost of the property-related service being provided.” *Id.* All assessments must be supported by a detailed engineer’s report prepared by a registered professional engineer certified by the State of California. *Id.* § 4(b).

II. APPLICABLE STANDARD OF JUDICIAL REVIEW

Courts are required to exercise independent review in assessing a public agency’s compliance with Proposition 218. *Silicon Valley Taxpayers Ass’n, Inc. v. Santa Clara Cnty. Open Space Auth.*, 44 Cal. 4th 431, 448-50 (2008). Generally, courts utilize a deferential standard of review in an action challenging the validity of a legislative or quasi-legislative action. *See, e.g., Poway Royal Mobilehome Owners Ass’n v. City of Poway*, 149 Cal. App. 4th 1460, 1479 (2007). Proposition 218 changed the standard of judicial review ordinarily applicable to a legislative action to form an assessment district. In a legal action contesting the validity of any assessment,

¹ On November 5, 1996, the California electorate approved Proposition 218, the self-titled “Right to Vote on Taxes Act.” Proposition 218 added two articles to the California Constitution: article XIII C, Voter Approval for Local Tax Levies; and article XIII D, Assessment and Property-related Fee Reform. Proposition 218 also included certain findings that were adopted by the voters but not made part of the California Constitution. Among those findings included the concept that Proposition 218 protects taxpayers by limiting the methods “by which local governments exact revenue from taxpayers without their consent.” Prop. 218, Gen. Elec. (Nov. 5, 1996). The Proposition 218 Omnibus Implementation Act, California Government Code sections 53750-53758, codifies Proposition 218’s procedures for each propertyowner’s approval of assessments and specifies that the notice, protest, and hearing requirements imposed therein supersede existing statutory requirements. Cal. Gov’t Code § 53753.

the public agency must demonstrate that the properties in question receive a special benefit over and above benefits conferred on the public at large and that the amount of any contested assessment is proportional to, and no greater than, benefits conferred on the properties in question. Cal. Const. art. XIII D, § 4. As a result, if a timely legal challenge is filed against the renewal of the Downtown PBID, the City will bear the burden of proof to demonstrate that the Downtown PBID assessments are permissible under all applicable laws. Any legal challenge to the validity of assessments must be commenced within 30 days after adoption of the Resolution of Formation levying the assessments. Cal. Sts. & Hwy. Code § 36633.

III. PROCESS FOR RENEWAL OF DOWNTOWN PBID

The Downtown PBID, as a previously established district whose term will expire on June 30, 2015, may be renewed through the procedures for establishment of a district under PBID Law. Cal. Sts. & High. Code § 36660(a). As discussed below, the City must follow a four-step process for renewal: (1) confirmation that a weighted majority of property owners within the district has submitted written petitions in support of the renewal; (2) adoption of the Resolution of Intention at a first public hearing; (3) confirmation that a weighted majority of property owners within the district has voted by ballot in favor of the renewal; and (4) adoption of the Resolution of Formation at a second public hearing.

As to the first renewal step, the City must receive written petitions in support of the renewal, signed by property owners in the district who will pay more than 50 percent of the assessments proposed to be levied. *Id.* § 36621(a). The petition must include a summary of the District Plan, including a map of the district boundaries, information specifying where the complete District Plan can be obtained, and information specifying that the complete District Plan will be furnished upon request. *Id.* § 36621(b). Each petition must be signed by “any person shown as the owner of land on the last equalized assessment roll or otherwise known to be the owner of land by the city council.” *Id.* § 36615. According to the City’s Economic Development staff, the City has received signed petitions from a weighted majority of the property owners in the Downtown PBID meeting the requirements under PBID Law.

Second, the City Council must hold a public hearing and consider adopting the Resolution of Intention, expressing its intention to renew the Downtown PBID. *Id.* § 36621(a). The Resolution of Intention must contain certain information, including, but not limited to, a brief description of the proposed improvements, maintenance, and activities, the amount of the proposed assessment, and the exterior boundaries of the district, and a statement as to whether the assessment will be levied on property or businesses within the district. *Id.* § 36621(c)(1). The Resolution of Intention must establish a time and place for a public hearing on the renewal of the Downtown PBID and the levy of assessments. *Id.* § 36621(c)(2). In this instance, the City Council will hold a public hearing on February 24, 2015, to consider adoption of the Resolution of Intention.

Third, if the City Council adopts the Resolution of Intention, the City must follow certain notice and ballot procedures prescribed by statute. The required notice and ballot must be mailed to each record owner in the district, defined as “the owner of a parcel whose name and address appears on the last equalized secured property tax assessment roll.” Cal. Gov’t Code § 53750.

Pursuant to Proposition 218, the City must provide all record owners with ballots on which to register their support or opposition to the District Plan. Cal. Sts. & High. Code § 36623; Cal. Gov't Code § 53753. Specifically, Proposition 218 requires 45-day mailed notice to the record owner of each parcel. Cal. Gov't Code § 53753(b). The notice must contain: the total assessment for the entire assessment district; the assessment chargeable on the owner's parcel; the duration of the proposed assessment; the reason for the assessment; the basis on which the amount of the proposed assessment was calculated; the date, time, and place of a public hearing on the assessment; and a summary of the voting procedures and the effect of a majority protest. *Id.*

Fourth, the City Council must hold a second public hearing and, if a weighted majority of the returned ballots has voted in favor of the renewal, the City Council must consider adopting the Resolution of Formation approving the ten-year renewal of the Downtown PBID. Cal. Sts. & Hwy. Code §§ 36623-36626. The ballots must be returned before the conclusion of the public hearing on the Resolution of Formation, at which time the ballots are then tabulated. No assessment may be imposed if a "majority protest" exists. Cal. Gov't Code § 53753; Cal. Sts. & Hwy. Code § 36625(a)(4). A majority protest exists if ballots submitted in opposition exceed ballots submitted in favor of the assessment, with the vote weighted according to the proportional financial obligation of the affected properties. Cal. Gov't Code § 53753. At the conclusion of the hearing on the Resolution of Formation, the City Council may adopt, revise, or reject the proposed renewal.² Cal. Sts. & Hwy. Code § 36624.

ANALYSIS

In recent years, California appellate courts have issued several decisions highlighting defects in the formation of certain assessment districts under Proposition 218 and other applicable laws. These court decisions have only provided examples of specific defects; they have not provided clear guidance on what would be sufficient to meet the requirements of PBID Law and Proposition 218. In light of these court decisions, and the possibility of new court decisions that may follow the same pattern, this Office has repeatedly advised that the formation and renewal of assessment districts will pose serious legal and financial risks for the City. Given that the City Council and Office of the Mayor have expressed their desire to continue to form and renew assessment districts within the City's limits, this Office has addressed multiple recurring legal issues in previous public and confidential memoranda issued since 2010. *See, e.g.*, City Att'y MS 2012-21 (July 27, 2012); City Att'y MS 2014-7 (April 15, 2014). This Office has discussed similar legal issues as applied to the proposed renewal of the Downtown PBID in a separate confidential memorandum.

² The procedural requirements for notice, protest, and hearing imposed by Proposition 218 "supersede any statutory provisions applicable to the levy of a new or increased assessment that is in existence on the effective date of this section, whether or not that provision is in conflict with this article." Cal. Gov't Code § 53753(a). If an agency complies with these procedural requirements in the formation of an assessment district, "then those requirements shall not apply in subsequent fiscal years unless the assessment methodology is changed to increase the assessment, or the amount of that assessment is proposed to exceed an assessment formula or range of assessments adopted by an agency in accordance with [Proposition 218]." Cal. Gov't Code § 53753.5(a).

One major legal issue is that, despite the California Legislature's recent attempts to clarify applicable law through amendments, certain legal requirements for the formation and renewal of assessment districts remain poorly defined and have not been examined in depth by California courts. For example, pursuant to Proposition 218, the City must determine the "proportional special benefit" to each property in relationship to the total cost of acquiring or constructing a public improvement, the maintenance and operational expenses of a public improvement, and any related services. *Id.* § 4(a). This must be accomplished through the engineer's report, a component of the District Plan in this instance and the required foundational document supporting the levy of assessments in any particular assessment district. *Id.* § 4(b). The California Legislature attempted to clarify the distinction between general and special benefits through recent amendments to PBID Law. A.B. 2618 (Reg. Sess. 2013-2014). Unfortunately, the proportionality requirement in Proposition 218 remains poorly defined despite these recent amendments.

In 2011, the Fourth District Court of Appeal examined the proportionality requirement in Proposition 218 but provided no guidance regarding any particular methodology for the apportionment of general versus special benefits that will ensure successful formation of an assessment district. *Golden Hill Neighborhood Ass'n, Inc. v. City of San Diego*, 199 Cal. App. 4th 416 (2011). The court in *Golden Hill* found that the engineer's report accompanying the formation of the Greater Golden Hill Maintenance Assessment District (GGHMAD) was defective, resulting in the dissolution of the GGHMAD in 2012.³ *Id.* at 439. Specifically, the engineer's report identified all services which would not have otherwise been routinely provided by the City, and considered those to be 100 percent special benefit. The court in *Golden Hill* disagreed with this approach, finding that essentially every improvement and activity provided by the GGHMAD resulted in some general benefit to members of the public outside of the GGHMAD, in addition to special and distinct benefits to property owners within the GGHMAD. *Id.* at 439. The court stated that "the agency must determine or approximate the percentage of the total benefit conferred by the service or improvement that will be enjoyed by the general public and deduct that percentage of the total cost of the service or improvement from the special assessment levied against the specially benefitted property owners." *Id.* at 438.

The engineer's report at issue in *Golden Hill* analyzed special and general benefits in the same manner that had been upheld in at least one previous appellate court decision. *See Dahms v. Downtown Pomona Prop. & Bus. Improvement Dist.*, 174 Cal. App. 4th 708 (2009). Nevertheless, the court determined that the GGHMAD engineer's report violated Proposition 218 in that it failed to do the following: (1) separate the general benefits to the public at large from the special benefits to the GGHMAD assessed parcels; (2) set forth a comprehensible assessment methodology to explain why City-owned open space was treated differently from other vacant parcels; and (3) explain why City-owned parcels were given greater voting weight and greater assessment obligation than other vacant parcels, thereby compromising the

³ The City established the GGHMAD under the Landscape and Lighting Act of 1972, California Streets and Highways Code sections 22500-22679 (MAD Act). The renewal of the Downtown PBID is being processed under PBID Law. For purposes of this memorandum, the distinction between the MAD Act and PBID Law is largely immaterial because the assessment districts formed under both of these statutes must comply with the requirements of Proposition 218. Those requirements are the main focus of *Golden Hill* and other pertinent court decisions.

transparency and integrity of the GGHMAD election process. *Golden Hill*, 199 Cal. App. 4th at 438-39. Other than a “hypothetical example” supplied in a footnote in the *Golden Hill* decision, there is not even a general road map that can help a public agency identify what methodology will meet the apportionment requirement.⁴ The governing laws and appellate court decisions do not specify the use of any particular methodology for the apportionment of general versus special benefits that will ensure successful formation of an assessment district.

Ultimately, renewal of the Downtown PBID entails both legal and financial risks, which may be avoided or mitigated to some degree by City actions. The City Council is responsible under PBID Law for adopting the Resolution of Intention and the Resolution of Formation related to the proposed renewal of the Downtown PBID for ten years. Cal. Sts. & Hwy. Code §§ 36621-36626. If a court orders the dissolution of the Downtown PBID, there is always the risk that the City could become liable for a substantial amount of assessments and legal expenses.

The City may explore several options to avoid or minimize risks associated with renewal of the Downtown PBID, such as: disapproving the renewal; not collecting or expending all or part of the assessment funds pending the outcome of any timely lawsuit; conditioning the expenditure of assessment funds on the City’s receipt of signed waivers from property owners; and relying on the Engineer’s contractual obligation to indemnify (but not defend) the City with respect to certain legal claims. In addition to any direct monetary exposure, the City would need to dedicate time, money, and resources to defending any legal challenge to the validity of the Downtown PBID assessments, and could become liable for the plaintiffs’ legal expenses in the event of a successful claim. In totality, these litigation expenses could be very substantial. In any event, this Office believes that the City, as a fiduciary for taxpayer funds, should retain the Mayor’s ability to freeze expenditure of assessment funds in the event of litigation.

⁴ The court in *Golden Hill*, using specially assessed street lighting as an example, suggested in a footnote that “a reasonable separation and quantification of general and special benefit would be to determine the approximate percentage of daily (or nightly) trips on the street made by the specifically benefitted residents as opposed to other members of the public and recoup only that percentage of the cost of the lighting through the special assessment.” 199 Cal. App. 4th at 438 n.18. This language should only be used as guidance, as it is not binding on the decisions of a lower court.

CONCLUSION

As the City Council considers whether to renew the Downtown PBID, it must determine whether the District Plan, including the engineer's report, contains reasonable and credible evidence that supports the basis and methodology for the proposed assessments.

JAN I. GOLDSMITH, City Attorney

By: /s/ Daphne Z. Skogen
Daphne Z. Skogen
Deputy City Attorney

DZS:dkr

MS-2015-4

Doc. # 957849

cc: Scott Chadwick, Chief Operating Officer
Mary Lewis, Chief Financial Officer
David Graham, Deputy Chief Operating Officer – Neighborhood Services
Lydia Moreno, Interim Assistant Deputy Director, Economic Development
Andrea Tevlin, Independent Budget Analyst