Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 533-5800

DATE: September 12, 2016

TO: Honorable Mayor and City Councilmembers

FROM: City Attorney

SUBJECT: Impact of Proposition H on Formation of Enhanced Infrastructure Financing Districts and Community Revitalization and Investment Authorities and Negotiation of Economic Development Incentive Agreements

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INTRODUCTION

Local voters passed Proposition H (Prop H) on June 7, 2016, amending the San Diego Charter (Charter) to add section 77.1 entitled "Infrastructure Fund." Commencing with the City's Fiscal Year 2018 budget, Prop H diverts 50 percent of specified growth of property tax revenues, transient occupancy tax revenues, and utility franchise fees received by the City for five years and 100 percent of specified growth in sales tax revenues and certain pension cost reductions for 25 years to a new City-administered Infrastructure Fund. Money in the Infrastructure Fund may only be spent on "Infrastructure" that is defined to include "capital improvements including streets, sidewalks, bridges, bike paths and related right-of-way features, storm water and drainage systems, public buildings such as libraries, recreational and community centers, public safety facilities such as police, fire and lifeguard stations, and park facilities."[1] Any revenues that are "otherwise legally committed to other uses, such as sales tax rebate agreements," are defined in Prop H as "Exempt Revenues" and not diverted to the Infrastructure Fund.

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[1] The City Council may, in its discretion, adopt a future ordinance to include software and other technology that is capital in nature (having a useful life in excess of five years) in the definition of Infrastructure under Prop H.

QUESTIONS PRESENTED

1. Can revenues that would otherwise be diverted by Prop H to the Infrastructure Fund be legally committed to other uses and classified as Exempt Revenues on or after the July 1, 2017, operative date of Prop H?

2. Does Prop H, once it becomes operative, prevent the City from committing certain property tax increment revenues to any new Enhanced Infrastructure Financing District (EIFD) or Community Revitalization and Investment Authority (CRIA)?

3. Can money in the Prop H Infrastructure Fund be used to pay for all or a portion of Infrastructure improvements financed by an EIFD or a CRIA created by the City?

4. Does Prop H, once it becomes operative, prevent the City from committing certain property tax and sales tax revenues under any new economic development incentive agreement (EDIA) with a local business?

5. Can money in the Prop H Infrastructure Fund be used to pay for all or a portion of Infrastructure improvements required for private development, pursuant to an EDIA?

SHORT ANSWERS

1. No. The most reasonable interpretation of Prop H is that any allocation of revenues must occur before July 1, 2017, to be considered within the definition of Exempt Revenues under Prop H. Allowing future City Councils to legally commit any of the specified revenues diverted by Prop H to the Infrastructure Fund for other uses, and turn these revenues into Exempt Revenues that are not required to be deposited into the Infrastructure Fund, would frustrate the stated intent of Prop H to establish a dedicated revenue stream for the construction of Infrastructure commencing in Fiscal Year 2018.

2. Yes. From July 1, 2017, through June 30, 2022, Prop H reduces available City property tax increment revenues, including Vehicle License Fee Property Tax Compensation Fund revenues, that may be pledged by the City to an EIFD or a CRIA created after June 30, 2017.

3. Yes. Financing from a City-created EIFD or CRIA could be combined with money from the Infrastructure Fund to pay for the costs of construction of Infrastructure.

4. Yes. During the operative time period of Prop H, the City may only use City property tax and sales tax revenue base year amounts or the 50 percent of property tax incremental growth amounts that are not diverted to the Infrastructure Fund to finance EDIAs.

5. Yes. To the extent the City requires a private development to construct Infrastructure, the City could use money from the Infrastructure Fund to pay all or a portion of the costs of construction of such Infrastructure, pursuant to an EDIA. Prop H requires

Infrastructure Fund money to be spent on Infrastructure, but does not limit the circumstances under which Infrastructure is constructed.

BACKGROUND

The City is considering creating one or more EIFDs or CRIAs that are anticipated to be primarily financed from City property tax increment revenue. *See* Cal. Gov't Code §§ 53398.50-53398.88 and 62000-62208. City staff working on these financing district formations requested guidance regarding the impact of Prop H on City property tax increment revenues available for these financing districts because Prop H diverts certain City property tax increment revenues to the Infrastructure Fund.

Additionally, the City is contemplating one or more EDIAs with local businesses that are proposed to be funded from City property tax or sales tax revenues, or both. Therefore, these agreements may also be impacted by the Prop H diversion of specified amounts of future City property tax and sales tax increment revenues to the Infrastructure Fund.

ANALYSIS

I. REVENUES DIVERTED BY PROP H TO THE INFRASTRUCTURE FUND CANNOT BE LEGALLY COMMITTED TO OTHER USES AFTER JUNE 30, 2017

Prop H became effective upon its filing with the California Secretary of State on July 18, 2016. Cal. Const. art. XI, § 3. Thereafter, Prop H becomes operative and begins diverting certain City revenues to the Infrastructure Fund during the City's Fiscal Year 2018 budget period, beginning on July 1, 2017.[2]

The second sentence of Prop H states that the intent of Prop H is to require the City to dedicate specific sources of revenue to fund General Fund infrastructure. The word "dedicate" means to set apart to a definite use. *Dedicate*. Merriam-Webster Online Dictionary, http:www.merriam-webster/dictionary/dedicate (last visited August 26, 2016). Thus, the intent of Prop H is to divert specified City revenues into the Infrastructure Fund to be used solely for paying the costs of Infrastructure and bind each future City Council to this use of the specified City revenues.

Prop H provides for Exempt Revenues not to be deposited into the Infrastructure Fund. Exempt Revenues are revenues that would be deposited into the Infrastructure Fund, but are legally committed to other uses by law or contract.[3] The Prop H definition of Exempt Revenues is ambiguous, on its face, because it does not state when funds must be legally committed to other

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[2] A law may have an effective date and a different operative date. *Callahan v. City & County of San Francisco*, 68 Cal. App. 2d 286, 290 (1945).

[3] Revenues already dedicated by the Charter or law to other purposes are excluded from the definition of "Major Revenues" under Prop H, which includes City property tax revenues, unrestricted General Fund transient occupancy tax revenues, and unrestricted General Fund franchise fees. There is no such exclusion from the definition of "Sales Tax Revenue" under Prop H.

uses to be classified as Exempt Revenues. Three potential alternative interpretations of Exempt Revenues are: (1) City revenues could be legally committed to other uses, at any time, and be classified as Exempt Revenues that are not required to be deposited into the Infrastructure Fund; (2) City revenues must be legally committed to other uses before the effective date of Prop H (as opposed to the subsequent operative date) to be classified as Exempt Revenues; or (3) City revenues must be legally committed to other uses before Prop H becomes operative on July 1, 2017, to be classified as Exempt Revenues. As discussed below, the third interpretation is the most reasonable of the three potential interpretations.

To determine the meaning of Exempt Revenues in this context, general canons of statutory construction must be applied. Under one of these canons, a court should not give one provision of a law a meaning that renders another provision of the law meaningless. *Gaetani v. Goss-Golden West Sheet Metal Profit Sharing Plan*, 84 Cal. App. 4th 1118, 1129 (2000). "A construction which makes sense of an apparent inconsistency is to be preferred to one which renders statutory language useless or meaningless." *Texas Commerce Bank–El Paso, N.A. v. Garamendi*, 28 Cal. App. 4th 1234, 1243 (1994). "If the language is clear, there can be no room for interpretation; effect must be given to the plain meaning of the words." *Building Industry Ass'n of S. Cal. v. City of Camarillo*, 41 Cal. 3d 810, 818 (1986).

Further, the basic rule for interpreting a voter-approved amendment to a city charter is to effectuate the voters' intent in approving the amendment. *People v. Jones*, 5 Cal. 4th 1142, 1146 (1993). Statutory interpretations that defeat the objective of the statute will not be implemented by California courts. *Lusardi Construction Co. v. Aubry*, 1 Cal. 4th 976, 987 (1992). The words of a law must be read in context, considering the nature and purpose of the law and the statutory framework as a whole. *People v. Cottle*, 39 Cal. 4th 246, 254 (2006). If the meaning of the law is in doubt, the courts will look to the legislative history and the context within which the law was enacted. *Halbert's Lumber, Inc. v. Lucky Stores, Inc.*, 6 Cal. App. 4th 1233, 1238 (1992).

Applying these legal principles to Prop H, the most reasonable interpretation of Prop H is that any allocation of the specified City revenues to a purpose other than the Infrastructure Fund must occur before Fiscal Year 2018 begins on July 1, 2017, to be considered within the definition of Exempt Revenues under Prop H. Section (b) of Prop H states that the diversion of City tax revenues to the Infrastructure Fund begins "with the Mayor's Fiscal Year 2018 proposed budget," expressly providing that Prop H becomes operative in Fiscal Year 2018, commencing July 1, 2017.[4]

Interpreting Prop H to allow future City Councils to legally commit any of the specified City revenues diverted to the Infrastructure Fund for other uses at any time, and turn these revenues into Exempt Revenues that are not required to be deposited into the Infrastructure Fund, would render the Charter amendment meaningless or, at a minimum, substantially undermine its stated intent to establish a dedicated revenue stream for the construction of Infrastructure. Under such a broad interpretation of Exempt Revenues, money in the Infrastructure Fund could be allocated by

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[4] As a practical matter, any allocation of the specified revenues that is intended to constitute Exempt Revenues would need to occur in time to be included in the Mayor's proposed budget for Fiscal Year 2018.

future City Councils in the same manner as other General Fund revenues, without regard to the expenditure restrictions imposed by Prop H.[5,6]

Additionally, interpreting Prop H to require that City revenues must be legally committed to other uses before the effective date of Prop H (as opposed to the subsequent operative date) to be classified as Exempt Revenues, is inconsistent with the express language of Prop H providing that the diversion of specified City revenues begins in Fiscal Year 2018.

As explained above, the definition of Exempt Revenues under Prop H is susceptible to at least three alternative interpretations, one of which seems more reasonable than the other two. It is possible that a court would interpret the definition of Exempt Revenues under Prop H differently than this Office. In any event, local voters could be asked to consider approving a future Charter amendment clarifying the intended scope of Exempt Revenues under Prop H.

II. PROP H PREVENTS THE CITY FROM COMMITTING CERTAIN PROPERTY TAX INCREMENT REVENUES TO EIFDs OR CRIAs CREATED AFTER JUNE 30, 2017

From July 1, 2017, through June 30, 2022, Prop H reduces available City property tax increment revenues that may be pledged by the City to an EIFD or a CRIA created after June 30, 2017.

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[5] Prop H provides the City Council with limited implementing authority to adopt policies and definitions regarding use of the Infrastructure Fund, such as defining maintenance and repair functions related to Infrastructure (section (a)(3)), including certain software and technology in the definition of Infrastructure (section (a)(4)), defining operations related to Infrastructure (section (f)), and establishing policies and definitions related to the use of the Infrastructure Fund (section (j)). The City Council's limited implementing authority under Prop H relates to use of the Infrastructure Fund (i.e., expenditure of money deposited into the Infrastructure Fund). Nothing in Prop H authorizes the City Council to change the allocation of specified City revenues to the Infrastructure Fund. Thus, the City Council's limited implementing authority under Prop H does not allow the City Council to clarify or modify the definition of Exempt Revenues in Prop H to include agreements entered into during the operative time period of Prop H and financed with sales tax increment revenue that would otherwise be required to be deposited into the Infrastructure Fund.

[6] Exempt Revenues are defined in Prop H as revenues that "are otherwise legally committed to other uses." Revenues that "are already dedicated to other purposes" are excluded from Major Revenue under Prop H. Use of the word "already" in the exclusion from Major Revenues and omission of the word "already" from the definition of Exempt Revenues could be interpreted as an intentional temporal difference supporting an interpretation of Prop H that allows future City Councils to legally commit revenues that would otherwise be diverted to the Infrastructure Fund for other uses and convert these revenues into Exempt Revenues, at any time. Applying this temporal distinction in interpreting Prop H is problematic in two significant respects. First, it is unlikely that the electorate recognized or attached any significance to this temporal distinction when it voted to enact Prop H. Second, as previously discussed, allowing future City Councils to create Exempt Revenues at any time during the operative period of Prop H defeats or, at a minimum, substantially undermines the stated objective of Prop H to establish a dedicated revenue stream for construction of Infrastructure.

During this time, though, the City may pledge the 50 percent of property tax increment revenues not diverted to the Infrastructure Fund to finance an EIFD or a CRIA.[7]

The Vehicle License Fee Property Tax Compensation Fund (VLF Compensation Fund) is a method of compensating cities and counties for a reduction in vehicle license fee revenue resulting from an amendment to the California Constitution in 2004. Cal. Rev. & Tax. Code § 97.70. The VLF Compensation Fund is funded with ad valorem property tax revenue deposited into the County of San Diego Educational Revenue Augmentation Fund (ERAF). The City can pledge revenue from the VLF Compensation Fund to finance an EIFD or a CRIA.

The text of Prop H does not address whether money received by the City from the VLF Compensation Fund is considered City property tax revenue, such that 50 percent of the growth of this revenue is required to be deposited into the Infrastructure Fund. The annual growth in payments from the VLF Compensation Fund to the City is based on increases in assessed valuation of real property within the City and paid from ad valorem property tax revenues deposited into the ERAF. Therefore, revenue to the City from the VLF Compensation Fund is best characterized as property tax revenue to the City. The Office of the City Comptroller has confirmed that the City currently treats VLF Compensation Fund revenue as property tax revenue. As a result, money paid to the City from the VLF Compensation Fund is City property tax revenue for the purposes of Prop H, requiring that 50 percent of the growth of this revenue be deposited into the Infrastructure Fund, from July 1, 2017, through June 30, 2022. Accordingly, the amount of VLF Compensation Fund revenue diverted to the Infrastructure Fund will not be available for financing an EIFD or a CRIA created between July 1, 2017, and June 30, 2022, except indirectly as described in Section IV below.

III. PROP H PREVENTS THE CITY FROM COMMITTING CERTAIN PROPERTY TAX AND SALES TAX REVENUES UNDER EDIAs WITH LOCAL BUSINESSES AFTER JUNE 30, 2017

Prop H limits the City property tax and sales tax revenues[8] available to the City for financing EDIAs with local businesses after June 30, 2017. On July 1, 2022, though, the diversion of 50 percent of City property tax increment revenue will cease, alleviating some of the impact of Prop H on the City's ability to finance EDIAs. The diversion of City sales tax increment revenue will cease on July 1, 2042. During the operative time period of Prop H, the City may use City property tax and sales tax revenue base year amounts or the 50 percent of property tax increment revenue amounts that are not diverted to the Infrastructure Fund to finance EDIAs.

Historically, the City has only committed through EDIAs to provide economic development incentives in amounts measured by property tax or sales tax increment revenue generated by the

[7] The calculation of base year revenues and property tax increment revenues for either an EIFD or a CRIA would need to be reconciled with the definitions of similar concepts in Prop H to determine the precise amount of property tax increment that the City could pledge to a newly-created EIFD or CRIA.
[8] For purposes of this Memorandum, it is assumed that no transient occupancy tax or franchise fee revenue will be allocated under an EDIA because such an allocation is not contemplated for an EDIA under Council Policy 900-12, which sets forth the criteria on which the City provides economic development incentives.

incentivized local businesses, not measured by property tax or sales tax revenue base year amounts. In other words, the City has provided economic development incentives to local businesses in consideration of the additional revenue that the City anticipates receiving as a result of promoting the retention or expansion of the local businesses. The City could not follow this historical approach during the operative period of Prop H, except as described in Section V below.

IV. MONEY IN THE PROP H INFRASTRUCTURE FUND CAN BE USED TO PAY FOR ALL OR A PORTION OF INFRASTRUCTURE FINANCED BY AN EIFD OR A CRIA CREATED AFTER JUNE 30, 2017

Both an EIFD and a CRIA can finance construction of public infrastructure. Generally, neither an EIFD nor a CRIA will perform construction of public infrastructure. As a result, most, if not all, public infrastructure financed by a City-created EIFD or CRIA will likely be constructed by the City.

The Infrastructure Fund is limited to financing Infrastructure that can be financed by the City's General Fund. A City-created EIFD or CRIA may accept financial assistance from the City. Cal. Gov't Code §§ 53398.87 and 62002(g). Financing from a City-created EIFD or CRIA could be combined with money from the Infrastructure Fund to pay Infrastructure construction costs. Because Prop H diverts specified City property tax increment revenues into the Infrastructure Fund, though, the City cannot pledge City property tax increment revenues required to be deposited into the Infrastructure Fund to an EIFD or CRIA created between July 1, 2017, and June 30, 2022, as property tax increment revenue of the EIFD or CRIA. As a result, any EIFD or CRIA created during the Prop H operative period of July 1, 2017, through June 30, 2022, would not be able to pledge these City property tax increment revenues in support of tax allocation bonds and leverage these future City property tax revenues into immediate cash to pay Infrastructure project costs.

V. MONEY IN THE PROP H INFRASTRUCTURE FUND CAN BE USED TO PAY FOR ALL OR A PORTION OF INFRASTRUCTURE REQUIRED FOR PRIVATE DEVELOPMENT PURSUANT TO AN EDIA

As discussed in Sections I and IV above, the Infrastructure Fund may finance Infrastructure that can be financed by the City's General Fund. To the extent the City requires a private development to construct Infrastructure, the City could use money from the Infrastructure Fund to pay all or a portion of the construction costs for such Infrastructure, pursuant to an EDIA, reimbursement agreement, or other contractual arrangement with the private developer.[9] Prop H requires Infrastructure Fund money to be spent on Infrastructure, but does not limit the circumstances under which Infrastructure is constructed.

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[9] Depending on the factual circumstances, the City's financing of public improvements related to a private development could impose prevailing wage law requirements on the private development. *See* Cal. Lab. Code §§ 1720-1784.

Council Policy 900-12 also provides that the City, upon the City Council's approval, may reimburse the costs of public improvements for a project that are a required condition of the development from future revenues to the City generated directly from the project. Additionally, the City Council may waive application of Council Policy 900-12 in any given situation and approve EDIAs that use different financing than provided in Council Policy 900-12.

Council Policy 900-12 contemplates use of property tax and sales tax increment revenue to the City from local businesses to finance EDIAs. As the Infrastructure Fund is funded in part with this property tax and sales tax increment revenue, using Infrastructure Fund money to pay for Infrastructure required to be constructed as part of a private development project is consistent with the Council Policy 900-12 approach to financing EDIAs. Whether pursuant to Council Policy 900-12 or otherwise, the use of Infrastructure Fund money to pay for Infrastructure required to be constructed as part of a private development project will require the City Council's approval and one or more demonstrated public purposes.

CONCLUSION

Any allocation of City tax revenues that will be diverted to the Infrastructure Fund by Prop H beginning in Fiscal Year 2018 must occur before July 1, 2017, to be considered within the definition of Exempt Revenues under Prop H. Allowing future City Councils to legally commit any of the City tax revenues diverted by Prop H to the Infrastructure Fund for other uses during the operative period of Prop H, and turn these revenues into Exempt Revenues that are not required to be deposited into the Infrastructure Fund, would frustrate the stated intent of Prop H and render the Charter amendment meaningless or substantially undermine its stated intent.

Additionally, from July 1, 2017, through June 30, 2022, Prop H reduces available City property tax increment revenues, including VLF Compensation Fund revenues, that may be pledged by the City to an EIFD or a CRIA created between July 1, 2017, and June 30, 2022. Financing from an EIFD or a CRIA could be combined with money from the Infrastructure Fund to pay Infrastructure construction costs, but this form of financing could not be used to support the issuance of tax allocation bonds by the EIFD or CRIA.

[REMAINDER OF MEMORANDUM CONTINUED ON NEXT PAGE]

Further, Prop H limits the City property tax and sales tax increment revenues available to the City for financing EDIAs with local businesses, after June 30, 2017. As a general proposition, during the operative period of Prop H, the City may only use City property tax and sales tax revenue base year amounts or property tax increment revenue amounts that are not diverted to the Infrastructure Fund to finance EDIAs. One limited exception is that, to the extent the City requires a private development to construct Infrastructure, the City could use money from the Infrastructure Fund to pay all or a portion of the construction costs for such Infrastructure, pursuant to an EDIA or a similar agreement with the private developer.

JAN I. GOLDSMITH, CITY ATTORNEY

By /s/ Delmar G. Williams
Delmar G. Williams
Deputy City Attorney

DGW:dkr
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Doc. No.: 1325945_2
cc: Scott Chadwick, Chief Operating Officer
David Graham, Deputy Chief Operating Officer, Neighborhood Services
Mary Lewis, Chief Financial Officer
Lakshmi Kommi, Director, Debt Management
Andrea Tevlin, Independent Budget Analyst