THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED: October 31, 2007 REPORT NO. 07-171

ATTENTION: Council President and City Council
Docket of November 6, 2007

SUBJECT: Special District Formation and Financing Policy

REFERENCE: 1. Debt Policy Report to City Council (Companion Item)
2. Council Policy 800-03

REQUESTED ACTIONS:

Adopt the proposed Special District Formation and Financing Policy and repeal Council Policy 800-03, "Public Infrastructure Financing Assessment Districts and Community Facilities."

STAFF RECOMMENDATION – Approve the requested action.

SUMMARY:

I. BACKGROUND

In connection with a comprehensive City Debt Policy, the Department of Finance has developed a Special District Formation and Financing Policy (the "Special District Policy") (Attachment 1). The Special District Policy will appear as an appendix to the City Debt Policy, and is intended to provide uniform guidelines for Community Facilities District ("CFD")[1] and 1913/1915 Act Assessment District[2] ("Assessment District") formation and financing. Such Special Districts are typically formed to finance public infrastructure in connection with new development, but may also be formed to finance improvements pertaining to established communities. Subject to voter approval and once a district is formed, special taxes or assessments may be levied upon properties within a district to directly pay for facilities and certain services. Special taxes or assessments may also be levied to repay bonds issued to finance public improvements. These

[1] The Mello-Roos Community Facilities Act of 1982 permits a public agency to levy a special tax within a defined area to finance certain essential facilities, or to pay for certain services, when specific voting requirements are met.

[2] An Assessment District may be formed pursuant to the Streets and Highways Code Municipal Improvement Act of 1913. The associated bond acts, also contained within the Streets and Highways Code, include the Improvement Bond Act of 1915 and the Refunding Act of 1984, which provide for the issuance of bonds under various assessment proceedings and the refunding of assessment bonds, respectively.

Special Districts are primarily developer initiated, wherein a developer seeks a public financing mechanism to fund public infrastructure required in connection with its development. Special District formation may also be initiated by an established community.

<u>II. DISCUSSION:</u>

Currently, Council Policy 800-03 "Public Infrastructure Financing Assessment Districts and Community Facilities," ("Council Policy 800-03") established in 1965 and last amended by resolution on October 16, 1989, provides policy direction on the formation of CFDs and Assessment Districts. It is proposed that Council Policy 800-03 be repealed and that CFD and Assessment District formation and financing be addressed through the City Debt Policy, which would provide a more comprehensive and uniform approach to addressing this sub-topic as a part of the City's overall debt policy. A copy of Council Policy 800-03 is included as Attachment 2. Although key policy issues are covered in both the existing and proposed policies, because the format and approach to the proposed policy is significantly different from the existing policy (and the proposed action includes the repeal of Council Policy 800-03 in its entirety), a strike-out version of the Council Policy is not included.

Specific action approving the Special District Policy is requested because, under the Mello-Roos Community Facilities Act of 1982, Section 53312.7, a local agency must establish local goals and policies concerning its CFD formation activities. Currently, this requirement is met through Council Policy 800-03. It is proposed that the Special District Policy be adopted to meet this provision with respect to any future districts that may be formed by the City.

Listed and described below are certain key policy changes made in the proposed Special District Policy as compared to the existing Council Policy 800-03. These changes are consistent with recent trends in terms of how other municipalities across the state are approaching CFD and Assessment District formation and financing.

A. Provision of Services Component

In accordance with Section 53313 of the California Government Code, CFDs may provide funds for certain public services, including police and fire services, and recreation program services so long as they are in addition to, and do not supplant, services already provided within the territory.

- <u>Existing Policy (Council Policy 800-03, Section I.):</u> Provides that the use of CFDs to finance on-going services would be approved by the City "only under unusual and compelling circumstances."

- <u>Proposed Policy (Special District Policy, Section 10.4.E.):</u> Due to the significant budgetary impact that new facilities may place on the City in terms of on-going operations and/or maintenance costs (e.g., staffing and/or maintenance of fire stations, parks, etc.), proposed CFD financing for new facilities should provide funding for a portion of any associated on-going operations and maintenance costs, to the extent the services do not supplant services already being provided. At the time a CFD is formed, the City would need to identify existing service demands for the area, and these services would not be eligible for CFD funding. Development impacts that result in the need to allocate additional budgetary resources to maintain City-wide service levels is the area (e.g., an increase in the number of police officers due to an increase in population in the area resulting from the development) would be eligible for CFD funding.

B. Minimum Value to Lien Ratio

The security for CFD and Assessment District bonds is the value of the property securing the special tax or assessment lien. For these types of bonds, the investment community expects that the issuer will covenant to commence foreclosure proceedings against delinquent parcels of land in the event certain special tax or assessment delinquency thresholds are reached. Ultimately, if the delinquent special taxes or assessments are not paid, foreclosure proceedings would commence and the delinquent parcels would be sold to pay off the outstanding delinquent special taxes or assessments. To protect the credit quality of the bonds, and the interests of bondholders in the event delinquencies for a parcel reach a level requiring foreclosure action, it is important to establish an appropriate minimum value-to-lien ratio for Special District financings. The value-to-lien ratio is the ratio between the value of the land and improvements for a parcel of real property that would be subject to the special tax or assessment to the amount of bond principal allocable to such parcel and the share of principal allocable from any other outstanding bonds that are secured by a special tax or special assessment levied on the parcel.

- Existing Policy (Council Policy 800-03, Section III.A2.1.): The "value-to-lien ratio for all properties, after improvements are in place, within the district must be at least 3:1."

- Proposed Policy (Special District Policy, Section 10.5.A.): A value-to-lien ratio of at least 4:1 would be required. This could enhance the credit quality of any future issuance of Special District bonds.

C. Maximum Tax and Assessment Rates

As described above, once a CFD or Assessment District is formed, special taxes or assessments may be levied upon properties within a district to pay directly for facilities and services, or to repay bonds issued to finance the facilities. Establishing tax rate limitations is recommended in order to balance the need to finance public facilities and services in newly developing areas against the desire to avoid overburdening residents of those areas with special taxes or assessments.

- Existing Policy (Council Policy 800-03, Section III.A2.3.): "Total taxes and special assessments collected through the property tax bill should not exceed 2.00% of the assessed value of the property, including improvements."

- Proposed Policy (Special District Policy, 10.6.C.): Total taxes and assessments collected through the property tax bill should not exceed 1.80% of the expected assessed value of the parcel upon final sale of the property to an end user. In light of the significant increase in general property values within the City over the past decade (and therefore the value the maximum rate is applied against in calculating the amount of special taxes or assessments that could be levied), a lower maximum rate is proposed to limit the overlapping debt burden on any one parcel.

In general, other differences between Council Policy 800-03 and the proposed Special District Policy are that bond credit quality requirements or provisions have been added or enhanced (see Section 10.5 of the Special District Policy) and processes included in Council Policy 800-03 that are more administrative in nature or prescribed pursuant to local or state law (e.g,. methods of assessment for Assessment Districts, retention of construction contractors, and recovery of formation costs), are omitted or more generally addressed in the proposed policy. In addition, the Special District Policy specifies that the generally recommended method of Special District financing is CFDs versus Assessment Districts due to certain factors, as described in Section 10.3.E. of the proposed policy, such as greater flexibility in the types of facilities that may be financed and greater flexibility with respect to funding services.

The proposed Special District Policy also states that the City's ability to provide the resources necessary to implement new Special District financings must be considered in the context of competing needs for general City and Water and Wastewater Utility debt issuances. In addition, it contemplates that bond financing will not generally be utilized in conjunction with the proposed formation of smaller districts, defined as projects totaling less than $3.0 million to $5.0 million. For projects under $3.0 million to $5.0 million, bond financing is not typically cost effective and may not generally be justified in relation to the City's other financing priorities. However, such projects would be reviewed on a case by case basis and even if a financing is not recommended, an Assessment District may be formed, followed by a one-time enrollment of assessments to pay for the subject public facilities directly.

The proposed Special District Policy has been reviewed by the City Attorney's Office, City Planning and Community Investment, and an independent financial advisory firm, Fieldman, Rolapp & Associates, which has significant experience in Special District formation and debt issuance and has worked with many municipalities across the state, including other cities within the County of San Diego.

III. FISCAL CONSIDERATIONS:

None specific to this action.

IV. PREVIOUS COUNCIL ACTION:

The Debt Policy, including Appendix A (the Special District Policy), was presented to the Budget and Finance Committee (the "Committee") on June 6, 2007, and was discussed in further detail at the Committee meetings of July 25, 2007 and September 26, 2007. On September 26, 2007, the Committee's adopted action was to recommend the Debt Policy and the repeal of Council Policy 800-03 to the City Council.

Previous City Council actions include the adoption of Council Policy 800-03 by Resolution R-183351 on April 6, 1965, and the adoption of various amendments to such policy on the following dates: December 14, 1965 (R-185734); August 9, 1966 (R-188027); April 4, 1968 (R-193345); January 9, 1975 (R-212402); March 21, 1983 (R-258118); October 16, 1989 (R-274571).

V. COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

There were no community participation or outreach efforts.

VI. KEY STAKEHOLDERS & PROJECTED IMPACTS (if applicable):

Key stakeholders include future applicants for Special District formation and/or financing. Other key stakeholders include owners of property subject to a special tax or assessment lien and investors holding bonds in connection with Special Districts that may be formed in the future, and in accordance with the proposed Special District Policy.

Lakshmi Kommi	Jay M. Goldstone
Debt Management Director	Chief Operating Officer

Attachments:

(1) Proposed City of San Diego Special District Formation and Financing Policy
(2) Council Policy 800-03 (Public Infrastructure Financing Assessment Districts and Community Facilities)