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April 29, 1997

REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL

UPDATE ON THE STATUS OF PROPOSITION 218 AND ITS POTENTIAL IMPACTS ON THE CITY OF SAN DIEGO

INTRODUCTION

In the six months since Proposition 218 was passed by the electorate, local governments around the state have wrestled with the application of its provisions. Notwithstanding the section that admonishes interpreters to construe the provisions liberally in favor of its application, there is little real guidance in the proposition concerning the meaning or scope of many of its terms. Legislation and litigation will result in some clarification, but in the meantime, the City has engaged in an ongoing process of identifying the actual practices that are affected by Proposition 218.

In the course of this process, this office has rendered formal and informal opinions in a variety of situations. We have also worked with the City Manager's office in their preparation of previous reports to committees of the City Council. Those reports have summarized for you the provisions in each section of the measure, and we will not generally repeat such explanations here. The purpose of this Report is threefold: 1) to clarify certain aspects of the measure, 2) to bring you up to date on the determinations we have made regarding the effect of Proposition 218 in specific situations, and 3) to give you an overview of the pending legislation and litigation that may shape our future interpretation of its provisions.

SPECIFIC APPLICATIONS OF PROPOSITION 218

A. Taxes

1. *Voting on General Taxes.* One of the principal changes effected by the tax provisions of Proposition 218 is that charter cities like San Diego now must place all proposed general taxes on a ballot and obtain voter approval by a simple majority. This requirement is retroactive, and applies to all general taxes imposed, increased or extended on or after January 1, 1995. We have determined that the City has no general taxes that fall into this category, so, at this time,

there are no general taxes that need to be placed on a ballot. Any future increase in such taxes, e.g. the transient occupancy tax, will have to be voted on by the electorate.

2. *The retroactivity provision.* There has been considerable confusion about the application of the January 1, 1995 retroactivity provision. Proposition 218 applies retroactively only to general taxes and not any other means of local revenue raising. All other provisions of Proposition 218 are effective as of November 5, 1996.

3. *General versus special taxes.* In the past, a tax was generally considered a "general" tax and not a special tax if it went into the general fund. Proposition 218 now provides that a tax placed into the general fund may nonetheless be a "special tax," (thus triggering a two-thirds vote requirement) if it was imposed for a specific purpose. The purpose of the tax now unequivocally governs whether it is a general or special tax (and the required minimum vote) regardless of where in the City's treasury it is placed. Caution should therefore be exercised when proposing future tax increases, so that a tax intended as a general tax is not inadvertently "converted" to a special tax.

4. *Taxes versus assessments.* Nothing in Proposition 218 changes the fundamental distinction between taxes and assessments: a tax is calculated and imposed equally, without regard for the benefit conferred upon the person paying the tax, while an assessment is calculated and imposed upon a person by individually determining the degree of benefit that person receives from the assessment.

5. *Rental Unit Business Tax.* This tax has been challenged by two individuals asserting that it is barred by Proposition 218. However, it is not a tax that has been "imposed, increased or extended" within the retroactive time period set by Proposition 218; accordingly, unless and until the City elects to increase or extend the tax, it is not affected by Proposition 218.

B. Assessments

1. *Landscape Maintenance Districts.* Landscape maintenance districts are by definition covered by Proposition 218, as assessments placed on a parcel of property and imposed as an incident of property ownership. Certain districts may be "grandfathered," that is, excepted from the provisions of Proposition 218, if they are: 1) imposed exclusively to pay for the capital costs or maintenance of "sidewalks, streets[1], sewers, water, flood control, drainage systems or vector control"; 2) imposed pursuant to a petition signed by 100% of the parcel owners subject to the

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[1] Proposition 218 does not define "streets," and so currently we are left with the definition of "streets" found elsewhere in California law. This issue may be clarified by legislation or litigation.

assessment at the time the assessment is initially imposed; 3) imposed and the proceeds are used exclusively to repay bonded indebtedness; or 4) previously approved by a majority of voters[2].

San Diego has 34 landscape maintenance districts at present, and City staff is evaluating each one to determine which if any qualify for such an exception. Those districts would not have to be re-engineered and voted upon by the affected property owners unless the assessment was increased above the current approved maximum, or the methodology for computing the assessment was changed. To comply with Proposition 218, the remainder should be balloted by July 1, 1997. This office and City staff are retaining outside consultants to assist in making this determination as rapidly as possible to enable the City to meet the July 1 deadline.

2. *Business Improvement Districts*. By Memorandum of Law dated January 10, 1997, this office opined that 1989 Act Business Improvement Districts (BIDs) are not affected by Proposition 218 because they are not "property-related" and as such fall outside the scope of the definition of assessments covered by Proposition 218. The League of California Cities is in accord with our position. The Howard Jarvis Taxpayers' Association (HJTA) continues to disagree, conceding that they are not "assessments" covered by the measure but asserting that they are instead "special taxes." We disagree with this characterization, as addressed in our Memorandum of Law.

We had previously been told that the HJTA might file suit against our BIDs, but no suit was filed and more recently we were advised that they will not file suit on the Pacific Beach or Little Italy BIDs, but may look for other BIDs (here or elsewhere) to use as their test case.

3. *Parking Meter Districts*. Parking meter districts are not covered by Proposition 218. They are formed, by identifying an area that includes a number of parking meters, for the purpose of returning parking meter revenue to the district in which it is generated. Property owners in a parking meter district are not assessed anything in connection with the district; rather, the "assessment" is levied upon anyone using a parking meter. Because it is in no way "property-related," it is not a fee, charge or assessment within the reach of Proposition 218. Further, because it is a fee imposed only on persons who voluntarily use the parking space that is metered, and only for the specified time chosen by the person using it, the charge is not a "tax" within Proposition 218.

C. Fees and Charges

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[2] The term "voters" is not defined. Currently our interpretation is that, unless the Proposition specifically refers to a vote or election by the affected parcel owners, it means a vote or election by the entire electorate of the City.

With a few defined exceptions[3], all property-related fees and charges are now subject to certain requirements in order to be validly imposed and collected.[4] In addition to these substantive requirements, new or increased fees *other than* those imposed for sewer, water or refuse collection must be approved by either a majority of the property owners subject to the new or increased fee, or by a two-thirds vote of the electorate residing in the area affected by the new or increased fee. The choice of which procedure to use is up to the City.

1. *Sewer rates approved pre-218.* We have advised the Metropolitan Wastewater Department that the two six-percent (6%) increases approved by Council prior to Proposition 218 are not affected by the measure. The notification process in Proposition 218 applies to fees that are imposed or increased after November 5, 1996. Fees that were "existing" as of that date are not affected.

The League of California Cities has opined, and we agree, that if a fee was established by Council action prior to November 5, 1996, it was "existing " on that date even if its effective date is sometime after that. This is consistent with the provision, elsewhere in Proposition 218, that a general tax shall not be deemed to have been "increased" after the passage of Proposition 218 if it is imposed at a rate not higher than the maximum rate approved prior to the passage of Proposition 218. It is also consistent with statements by the proponents of the measure that assessments which were approved prior to Proposition 218's passage, and which contain automatic escalators or increases, shall not be deemed to have been increased unless and until the assessment is increased beyond, or changed from, the previously-approved increase or escalator.

Thus, while the two six-percent (6%) increases established prior to the passage of Proposition 218 should be deemed "existing" as of that date, future increases, above and beyond those already approved by Council, would have to comply with the substantive guidelines of Proposition 218.

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[3]Gas and electric fees and charges, plus developer-related fees discussed below.

[4] All fees covered by Proposition 218 must meet these five requirements: 1) they must not exceed the funds required to provide the service; 2) they must not be used for any other purpose; 3) they must not, on a parcel by parcel basis, exceed the amount necessary to provide the service to the affected parcel; 4) they must not be charged unless the service is actually used by, or immediately available to, the parcel owner; and 5) they must not be collected for any general governmental service, such as police or fire, that is as available to the general public as it is to the parcel owner. In other words, the parcel owner should not be paying more than the cost of the service, and should not be subsidizing a service equally available to or used by non-parcel owners.

2. *Storm drain fees.* Storm drains are designed to collect property runoff and therefore may be said to provide a service to the property. By memorandum to Deputy City Manager Coleman Conrad, dated March 18, 1997, this office opined that while there is no clear guidance on this question, two factors lead us to believe there is a strong likelihood that a court would find a storm drain fee increase to be subject to Proposition 218: 1) Proposition 218's expansive definition of "property-related fee," and 2) its admonition to construe its provisions liberally in favor of taxpayer consent. Unless and until future legislation or litigation clarifies this issue, we believe that the better practice is to treat storm drain fees as if they must comply with Proposition 218.

3. *Transfer of funds from the Water and Sewer Revenue Funds.* Proposition 218 does not allow funds generated by sewer and water fees to be used for purposes not related to sewer and water operations. We have taken the position that transfers of money from the Water and Sewer Revenue Funds are appropriate under Proposition 218 if they are made in consideration for a service or benefit conferred upon sewer operations. As an example, we have opined that money in the Sewer Revenue Fund generated by right of way charges may be transferred to the general fund, because they are generated as a result of, and represent the fair value of, the sewer operation's use of the City's right of way. The City Charter requires that, as an enterprise, the sewer operation must be charged for the use of the City's general fund assets (including its right of way) to the same extent that private utilities may be charged. Because the City confers the benefit of the use of the right of way upon the sewer operation, the City's general fund is entitled to be paid for that benefit just as any other private, exclusive user of that right of way (for example, SDG&E) pays the general fund. Thus a transfer of right of way charges from the Sewer Revenue Fund to the general fund represents a payment for a sewer-related purpose, and accordingly does not violate Proposition 218's restrictions on the use of sewer-related fees.

4. *Non-exclusive franchise fees.* These are fees imposed upon businesses involved in the collection of solid waste in the City. We have advised the Mayor and Council previously that we do not consider such fees to be "property-related," nor could they be considered a "tax," thus they are outside the scope of Proposition 218.

5. *Mandatory recycling fees.* Fees imposed on property owners for refuse collection fall within the scope of Proposition 218. Mandatory recycling fees would appear to be required to meet both the substantive and the voting requirements of Proposition 218. An argument can be made, however, that recycling fees which are user-based are closer to the type of "refuse collection" fees that must only meet the substantive requirements of Proposition 218 (but need not be voted upon, see footnote 4, above).

6. *Increases in water capacity and service charges.* We have advised Water Utilities that at this time it is unclear whether Proposition 218 applies to these charges. A number of

charges collected by Water Utilities are in the nature of cost recovery for services provided and are not property-related. It is less clear, however, whether water capacity and service charges would be considered sufficiently property-related to fall within the scope of Proposition 218. In an abundance of caution, we have advised Water Utilities to comply with the measure's noticing requirements prior to increasing capacity and service charges. However, even if the capacity are subject to Proposition 218, they are expressly exempt from the voter approval requirements and need only comply with the substantive requirements.

7. *Facilities benefit assessments and developer impact fees.* These fees, charged to developers as a cost of developing their property, are expressly exempt from the reach of Proposition 218. HJTA's explanation for this exemption is that "the focus of Proposition 218 is on those levies imposed simply by virtue of property ownership. Developer fees, in contrast, are imposed as an incident of the voluntary act of development."

LEGISLATION

SB 919 (the Rainey bill) and AB 1506 (the Ortiz bill) are currently pending in committees of the State Legislature. The Rainey bill includes clarifying provisions that the League of California Cities and the HJTA have agreed on, and may be passed as urgency legislation this year. The Ortiz bill is much more controversial, including many items that the League would like to see enacted but that HJTA opposes. The Rainey bill was scheduled for a third reading in the Senate on April 21, 1997, while the Ortiz bill is still being considered by the Assembly Local Government Committee. The Rainey bill may be signed into law as early as July of this year, but the Ortiz bill will likely be fought in the Legislature throughout the session.

A. The Rainey bill.

This legislation would clarify and simplify certain procedures, including measures that could reduce the cost of implementation. Among other things, it:

1. allows a special, local or consolidated election to be conducted by mail under limited circumstances;

2. allows a ballot measure proposing a tax to include a range or formula for imposing the tax; if the measure passes by the requisite number of votes, then the governing body can set the tax at any rate falling within the approved range or formula; and

3. provides certain non-controversial definitions for purposes of applying the assessment section of Proposition 218.

B. The Ortiz bill.

In addition to the above provisions in the Rainey bill, this legislation would provide additional relief to local governments, including provisions that:

1. could be read to carve user-based water and sewer fees out of Proposition 218, by providing that only fees which create a lien on the property (as opposed to creating personal liability on the part of the user) would fall within the scope of Proposition 218;

2. broadly define "streets" so that facilities in the right-of-way, including street lights, and other improvements, would unquestionably be included in the grandfathering provision for street maintenance; and

3. limit the scope of the measure's initiative provisions to those fees and charges covered by Proposition 218. HJTA argues that the new scope of the initiative power was intended to cover all fees and charges, not just those otherwise covered by Proposition 218.

In addition, there are a few provisions which had been in the Rainey bill until its most recent amendment, at which point the HJTA asked that they be taken out. Those provisions include:

1. A short statute of limitations for bringing suit to challenge a tax; and

2. A provision that, where part of an assessment district is "grandfathered," and part is not, only the non-grandfathered portion is subject to Proposition 218, and gives options for handling that non-exempt portion. Thus for example, if an LMD funds the maintenance of streets (which are grandfathered) and parks (which are not) within the same district, only the portion of the assessment used for the parks must be: 1) re-engineered and voted upon, or 2) withdrawn from the district and the assessment. A third option is for the City to put the entire LMD up for a vote by the affected property owners.

It is likely that the Ortiz bill will be amended to include these and other provisions.

LITIGATION

Only one court decision has been rendered in a Proposition 218 case to date. The County of Los Angeles brought suit asking the court to declare that its fire assessment district was exempt from Proposition 218, but the court denied the County this relief. We have not yet analyzed how, if at all, this decision by the Los Angeles Superior Court would influence our

analysis of any of our own districts. Appellate court decisions will be far more helpful in this regard, but we are not aware of any such decisions that are pending or expected at this time.

CONCLUSION

We continue to address specific questions raised by City staff regarding the application or non-application of Proposition 218's provisions, as City departments consider the fees, charges, assessments and other revenue sources that are involved in their day-to-day operations and long-range planning. To date, the impact of Proposition 218 on our current tax-based revenues appears small, while the impact on fee-based revenues is not yet clear. Assessment districts are still being evaluated on a case-by-case basis. Those that are not "grandfathered" and must comply with Proposition 218 by July 1, 1997, may require policy determinations that will require comparing the costs of engineering and balloting, to the revenues generated by the assessment and the degree to which the affected community desires to continue receiving the benefits of the district.

We will keep the City advised as further guidance and clarification concerning the interpretation and application of Proposition 218 becomes available.

Respectfully submitted,

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04/29/97
RC-97-7