

Project Memorandum #2: Current Legal and Institutional Context for Financing Flood Protection

March 2016

PURPOSE AND FINDINGS

This memorandum is the second in a series that describes the set of facts and assumptions that will be used in the Delta Flood Risk Management Assessment District Feasibility Study (the study). In particular, this memo outlines key State constitutional and statutory provisions that limit State and local government agencies' ability to raise revenue to maintain and improve Delta levees. As the starting point for the feasibility study, this memo describes existing constraints on assessments, fees, charges and other revenue options. A future memorandum will analyze which financial mechanisms are most promising and applicable to Delta levees. That analysis will also examine constraints, opportunities and challenges of applying the "beneficiary-pays" approach across the spectrum of Delta levee beneficiaries.

Based on this review of legal and institutional constraints, we cannot yet exclude any general category of financing mechanism from the study; examples of similar applications exist in all seven of the categories examined herein. Substantial legal uncertainty exists regarding the application of new assessments, fees, charges and taxes to the regional or statewide beneficiaries of Delta levees, which inhibits drawing ready conclusions about the feasibility of such fees and taxes to pay for levee improvements and maintenance.

Summary of Financing Mechanisms Available

Propositions 13, 218, 26, and associated case law have imposed significant limitations and procedural requirements on government's ability to raise revenue.¹ This memorandum summarizes California's state and local revenue generation mechanisms most commonly used for infrastructure financing, and describes how they might apply to financing levee improvements. The mechanisms are organized in the following broad categories:

- assessments,
- general and special taxes,
- impact fees,
- property-related fees and charges,
- regulatory charges, and
- user fees.

Different constraints apply to each of the categories listed above, depending on whether they are employed by state, regional, or local government agencies. Consequently, the utility of each option varies in its application to financing levee maintenance and improvements. This memo defines these

¹ The impacts of Propositions 13, 218 and 26, along with associated statutes and case law, is a complex area of law and legal practice, which we greatly simplify here for the purposes of this context memorandum.

categories, and describes their requirements and limitations as they might apply to financing levees. An appendix summarizes the key considerations in a table format.

DEFINITIONS

The following definitions generally describe state and local government revenue options. We have provided these definitions to lend clarity to the discussion. We recognize that voter-enacted initiatives – Propositions 13, 218, and 26 – have used these terms or phrases inconsistently or without definition, thus blurring the line as to how and for what purpose a particular revenue measure should be categorized. The initiatives, associated case law, and statutes sometimes provide more particular or varied definitions.

“Assessments” refer to any levy or charge imposed upon real property by an agency. They include, but are not limited to special assessments, benefit assessments, maintenance assessments and special assessment taxes.² Assessments are levied based upon the benefits conferred upon the assessed real property resulting from a government service or public improvement.³

“Impact Fees” are charges imposed as a condition of land development (e.g. building permit, rezoning or conditional use permit or subdivision approval), intended to fund public facilities and services necessary to serve the new development. Common examples include city park and road impact fees. Impact fees are not for general revenue purposes and the fees must be based upon a reasonable relationship between the development project and the facility or service to be provided. This reasonable relationship is commonly referred to as the “nexus.”

“Local Agency” ordinarily includes cities, counties, special districts and any other local or regional governmental entity.⁴

“Property-Related Fees and Charges” lack a precise definition, but as result of Proposition 218 are broadly considered to be any fees or charges *other than an ad valorem tax*,⁵ special tax or assessment which are imposed by an agency upon a parcel or person as an incidence of (*i.e.*, connected directly to) property ownership. An example is a groundwater augmentation charge fee collected from overlying property owners.⁶

“Regulatory Charges” is used to describe charges imposed by a public agency in conjunction with implementing a regulatory effort such as monitoring air and water quality regulations or an industry-imposed charge to fund, for example, lead paint removal.

“Taxes” (General and Special) are charges on real property which historically are not tied to any particular service or benefit provided by the public agency. As a result of voter approved initiatives, a “general tax” is any tax imposed for general governmental purposes. A “special tax” is any tax imposed for specific purposes including taxes placed into the general fund for particular purposes. Taxes by special districts are now considered to be “special taxes.”

² California Constitution, Art. XIII D, Sec. 2.

³ Note that there is not a requirement that benefits exceed costs; however, “ability to pay” studies such as those usually conducted as part of levee project planning and financing, typically incorporate such a requirement.

⁴ California Constitution, Art. XIII C, sec. 1.

⁵ “Ad valorem” refers to a tax determined as a proportion of property value.

⁶ Pajaro Valley Water Management Agency v. Amrhein (2007) 150 Cal.App. 4th 1364

“User Fees” characterizes fees collected in response to the use of a governmental service or facility, such as application processing charges or rental of public property such as a sports facility. These services must be separable from direct use of the property itself. Utilities, such as water, sewer and electricity, fall into this category because use varies without direct relationship to the property’s characteristics.

CURRENT FINANCING MECHANISMS

Assessments

Assessments are used by cities, counties and special districts to fund a variety of government activities. Funded activities include parks and recreational improvements, landscaping, and street lighting. Assessments can be utilized to funding ongoing re-occurring expenses as well as for funding the repayment of bonds sold to finance long term capital expenditures.

Historically, assessments have served as a primary tool for local funding of levee improvements and maintenance, and are frequently imposed by reclamation districts. Reclamation districts are special districts of limited powers, formed to protect distinct geographic areas within the Delta region, and administered by an independent governing body, separate from city and county governments. Reclamation districts are some of the oldest forms of government recognized under California law, and are formed under general statutory authority or by special legislative acts.

Assessments are based upon and levied in accordance with benefits provided to the affected property by the governmental service or activity funded by the assessment. Proposition 218 (1996) constrained local agencies’ use of assessments by imposing both procedural and substantive requirements for new assessments.⁷ These include a requirement that only special benefits (and not general benefits) may be assessed, and assessments must be based upon a detailed engineer’s report.⁸ This report must quantify the proportional special benefit derived by each parcel. Special benefits are identified as separable from those conferred generally to the surrounding community. For example, a set of parcels may derive a lower risk from flood protection or may be more susceptible to a flood hazard than surrounding parcels. The assessment cannot exceed the reasonable cost of the special benefit conferred upon the parcel.

Procedural steps added by Proposition 218 require the local agency to conduct a hearing with notice to the property owner and to conduct a ballot protest proceeding prior to imposing the assessment. If the ballots opposing the measure exceed those in support, the agency may not impose the assessment. Protest ballots are weighted in accordance with the proportional financial obligation of each parcel. Thus, although they do not vote on the assessment, property owners have a direct role in determining whether or not a locally imposed assessment can go forward.

Proposition 218 requirements apply to “local agencies,” which would include cities, counties, special districts and regional governmental agencies. The State does not directly exercise assessment authority for levee improvements. Were the State to create a new regional agency for purposes of imposing assessments to fund levee improvements, the new agency would have to follow the same procedural and substantive steps as a city, county or special district. The challenge would come in the determination of the “special benefit” for each parcel in the region, and establishing the nexus between the cost and the amount to be assessed.

⁷ Certain pre November 6, 1996 assessments are exempt.

⁸ Engineer’s reports have long been required, but are now key to the only avenue available for using assessments.

It is unclear whether assessments could be applied to capture the benefits of levees that accrue to beneficiaries outside of the Delta, e.g., water exporters or users. Under existing law, an assessment district cannot assess outside its boundaries. And because assessment districts only assess real property, the conveyance of water is not likely to be an assessable activity.

General and Special Taxes

The law pertaining to general and special taxes has evolved over the last forty years, starting with the enactment of Proposition 13 in 1978, followed by Propositions 218 and 26. Combined, these initiatives created the following framework for the imposition of taxes, both general and special.

Proposition 13 added Article XIII A to the California Constitution in 1978, capping, and in many situations lowering, the property tax revenues collected by cities, counties, school and special districts. The measure established a maximum cumulative *ad valorem* tax rate of 1% based upon assessed value of the property, with annual reassessment escalation limited to no more than 2% until a property is sold or ownership is significantly modified. Proposition 13 also required local voter approval for special taxes and restricted the California Legislature's ability to enact new taxes by imposing a requirement of a two-thirds vote in both legislative houses. Proposition 13 authorized cities, counties, and special districts to enact "special taxes" following a two-thirds vote of the qualified electors, although the measure did not define "special" taxes.

Proposition 218 supplemented Proposition 13. Under Proposition 218, a majority of voters must approve new general taxes, and two-thirds of the qualified voters must approve local special taxes. The voter approval requirement reduces the flexibility of local agencies to rely upon new tax measures to create additional revenues. The measure also clarified the use of the initiative process to repeal locally-imposed taxes, assessments, fees and charges, adding a level of uncertainty as to the long term reliability of new revenue measures.⁹

Proposition 26 in 2010 took a sweeping approach to taxes, defining "taxes" to include any local levy, charge or exaction, effectively expanding the voter approval requirement to more local government actions. Proposition 26 exempted some fees and charges from the two-thirds voter approval requirement—those relevant to levee funding are:

- charges imposed for a specific benefit conferred to the payor that is not provided to those not charged, or for services provided, subject to a limitation that the charge not exceed the reasonable cost to the government of providing the benefit or service. (Levee maintenance could fall within the scope of "benefits" conferred or "services" provided, and would possibly be exempt from Proposition 26, although the scope of the Proposition has not been fully litigated.)
- A charge imposed as a condition of property development, as is the case with impact fees (discussed below).
- Assessments and property-related fees imposed in compliance with the provisions of Proposition 218 discussed above (*i.e.*, engineer's report capture of special benefits and weighted protests.)¹⁰

Thus, as to local governments, Proposition 26 leaves in place local options for levee financing through assessments (discussed above) or impact fees (discussed below) but constrains the use of new taxes by

⁹ Repealing such charges related to repaying bond indebtedness is restricted.

¹⁰ California Constitution Article XIII D, sec. 1.

the two-thirds voter approval requirement. Local levee maintenance charges (based upon the reasonable cost of the government agency) might also qualify as benefits or services and would be exempt from Proposition 26's voter approval requirement as long as benefits or services are not provided to non-payers. The challenge would lie in proving that non-payers do not receive benefits from levees. Traditionally, benefits of levees have been viewed as accruing entirely to the parcels directly protected by those levees. Expanding the list of beneficiaries of flood control levees to others (as will be done in this study) is a relatively recent innovation, and has not yet been addressed by the courts. Expanding the list of beneficiaries (e.g. to owners/users not located behind the levee) may run afoul of the voter approval requirement unless the local agency imposing the charge can charge *all* beneficiaries. Additionally, cities, counties and special districts are geographically constrained by their jurisdictional limits in exercising their legal powers.

Proposition 26 also affected the State's ability to raise revenue by compelling a two-thirds vote in both houses of the Legislature for new taxes.¹¹ At the State level, the Proposition expansively defines taxes with broad language similar to that applicable to local governments, and contains similar exemptions from the definition of "taxes." State-imposed charges for levee maintenance and/or improvements (again based upon the reasonable cost to the State) may similarly qualify as a benefit or service to the payor which would not be treated as a tax (and thus not triggering the supermajority vote in both houses.) Depending upon how the courts interpret Proposition 26, the supermajority requirement could be a significant hurdle to a State-imposed charge for levee improvements and maintenance.

Special taxes are a feature of community facility districts ("CFDs"), which are not independent special districts—rather, CFDs are taxing districts administered by government agencies. Special taxes are frequently used in conjunction with new development to finance infrastructure and maintenance, authorized by the Mello-Roos Community Facilities Act ("CFA") of 1982.¹² The reason for the more frequent use of special taxes in new development is that the initial property developer controls the voting power in the district before residents move in and can readily satisfy any required voting/protest provisions. A significant distinction between CFA special taxes and other revenue tools is that CFA taxes are not limited by the rigors of the benefit analysis (assessments), nexus (impact fees), or reasonableness (user charges.) Special taxes (except those used to retire bonded debt) can be repealed by the voters in future years as a result of Proposition 218. As these special taxes are closely linked to new land development, the utility of CFD special taxes in the Delta Primary Zone is very limited, although they may apply to urban development in the Secondary Zone.

General taxes can be used to repay debt from general obligation bonds issued for flood protection improvements, such as those described in this study's memo on "Historic Investments in Delta Flood Protection."

Impact Fees

In 1986, the California Legislature enacted the Mitigation Fee Act, AB 1600, which created a uniform process governing the adoption, collection, and accounting for "impact fees."¹³ These fees have been defined as those imposed either on the basis of broadly-based legislative enactments which establish a uniform fee applicable to a type of development activity (for example, a city's impact fees for major roadways) or on an *ad hoc* basis, as determined by the specifics of a particular development project.

¹¹ California Constitution Article XIII A, sec. 3.

¹² Government Code section 53311 *et seq.*

¹³ Gov. Code section 66000 *et seq.*

These fees are used to finance the construction or rehabilitation of public capital facilities. When adopting or imposing a fee obligation as a condition of approval, a local agency must make certain findings as to purpose, the use of the funds and the reasonableness of the fee as between the project and the public facility. AB 1600 codified the constitutional doctrine that impact fees must be reasonably related, or have a “nexus” between the project or activity upon which the fee is imposed and the facility to be financed. As a general proposition, impact fees collected from new development cannot be used to remedy existing facility deficiencies. For example, impact fees probably cannot be used to address levee maintenance shortfalls, but such fees may be used to upgrade or replace a levee, or build a new levee. Once fees are collected, a local agency must periodically affirm the purpose and reasonable relationship between the fee and facility to be constructed.

The Mitigation Fee Act applies to locally-imposed impact fees assessed against new land development activities, for which the fee revenues would be used for levee construction or rehabilitation. Cities and counties have the inherent constitutional authority to adopt and impose impact fees, but special districts do not share the same inherent power to adopt impact fees and must be granted specific legislative authorization by the California Legislature in order to adopt impact fees.

As impact fees are tied to new land development activities, restrictions on development within the Delta’s Primary Zone reduce the potential for impact fees to serve as a significant revenue source, although they may apply in the Secondary Zone. As a general proposition, the State does not impose impact fees but that does not mean that this option is unavailable.

Property-Related Fees and Charges

The controlling legal authority pertaining to property-related fees and charges was added by Proposition 218.¹⁴ This Proposition established, among other provisions, new procedural and substantive rules applicable to local agencies when imposing charges based upon property ownership. Generally, the limitations on property-related charges for services include:

- Certain property-related charges must be preceded by mailed notice to the property owners coupled with a right of protest. This step allows the property owners by majority protest to veto the proposed charge. This voting is not weighted.
- Revenues cannot exceed the proportional costs required to provide the property-related service.
- Fees cannot be charged for general government services (e.g. police, fire) which are otherwise available to the public.
- Services for which fees are charged have to be readily available to the property.
- New property-related fees and charges¹⁵ would be subject to approval by either a majority of the property owners or two-thirds of the registered voters.

Note that in contrast to assessments, in which costs are allocated in proportion to the *benefits* accruing to the property from the service or activity, these fees and charges are allocated based on the *costs* of providing those services or activities to each particular property. In addition, assessments can be approved by the local agency’s legislative body, subject to protest, while property-related fees and charges must be approved electorally as described above.

¹⁴ California Constitution Article XIII D, Section 6.

¹⁵ Other than charges for sewer, water and refuse collection.

As a funding option for levee improvements, the requirement that the service “be readily available to a property” may function as a constraint on the use of locally-imposed property related charges for levee-related work. This is because the connection of the service to the parcel is less tangible and apparent when compared to other services such as delivering potable water to a residence. Future improvements, by definition, may not be “readily available now,” whereas ongoing levee maintenance would be a current activity with current benefits. Thus far, court cases have dealt with active services like turning on the spigot for water; the “service” of reduced flood risk is less tangible and immediate. It is not at all clear whether property-related charges could be employed to capture the “service” of water supply conveyance for use outside the Delta.

Regulatory Charges

These charges typically occur in conjunction with a regulatory endeavor and would not include revenue collected for general purposes. Proposition 26, passed by the voters in 2010, comprehensively defined as a tax “any levy, charge or exaction,”¹⁶ triggering voter approval at the local government level (or passage by a two-thirds vote in the legislature for state imposed charges) unless the tax was specifically exempted from the scope of the Proposition. These exemptions include charges for regulatory programs subject to the limitation that the charge cannot exceed the reasonable cost of the benefit, service or activity provided,¹⁷ and the revenues cannot be used for general fund purposes. The state legislature can delegate the authority to collect such fees to state and subordinate regional agencies.

As an example, the State Water Resources Control Board uses several regulatory fees for a variety of programs,¹⁸ as do the Regional Water Quality Control Boards. Such fees typically pay for administrative costs, but have been used for specific projects.

User Fees

As a general proposition, user fees cannot exceed the reasonable cost of providing the benefit, service or regulation, and thus cannot be relied upon for general revenue purposes.¹⁹ Typically, user fees are limited to utility, permitting or access fees which involve one-on-one transactions between a client and the government agency. User fees are also covered by the limitations of Proposition 26 as discussed above under General and Special Taxes. User fees and charges for services delivered to a property may be subject to Propositions 218 and 26 as property-related charges. User fees would have a narrowly-defined role as a financing tool in the Delta; they are typically associated with the use of public facilities such as boating facilities.

¹⁶ California Constitution Article XIII C, sec. 1 (local agencies) and Article XIII A, sec. 3 (state).

¹⁷ California Constitution, Articles XIII C Section 1(e) and XIII A sec. 3

¹⁸ See <http://www.waterboards.ca.gov/resources/fees/>.

¹⁹ Proposition 26 does not include a “reasonable cost” limitation on use of property.

APPENDIX A

The table below summarizes selected legal characteristics/limitations associated with the seven categories of revenue tools described in this memorandum.²⁰

Revenue Option	Cities and Counties	Special Districts	State of California
Assessments	Proposition 218 procedural and substantive limitations apply: engineer's report, capture of special benefits only, hearings, majority protests based upon weighted voting tied to relative financial obligations. The assessed property must specifically benefit from the improvements or services.	Same as cities and counties.	Prop. 218 assessment requirements do not apply to the State. Current State assessment activity is non-existent or limited at most. State assessments may require a 2/3rds vote of both legislative houses unless the tax (charge) is reasonably related to the cost of a benefit, service, facility or regulatory effort being provided to the payor.
General Taxes	<i>Ad valorem</i> property taxes are capped by Proposition 13 at 1% of full cash value. New general taxes, where revenues are collected for general revenue purposes, must be approved by the local voters.	<i>Ad valorem</i> property taxes are capped by Proposition 13 at 1% of full cash value. Special districts may be entitled to a historic proportionate share of property taxes. Special districts cannot levy a general tax.	<i>Ad valorem</i> property taxes capped by Proposition 13 at 1% of full cash value. New taxes require a 2/3rds vote of both legislative houses unless the tax (charge) is reasonably related to the cost of a benefit, service, facility or regulatory effort being provided to the payor.
Special Taxes	As stipulated by Proposition 218, new	Same as cities and counties.	New state taxes require approval by

²⁰ This table is not intended to provide a detailed discussion of the constitutional and statutory requirements and limitations which may impact the selection of a particular revenue strategy in any given situation.

Revenue Option	Cities and Counties	Special Districts	State of California
	<p>special taxes are subject to 2/3rds voter approval. (Prop. 218) Tax revenues can only be used for the purpose for which the tax is collected.</p>		<p>2/3rds vote in both legislative houses unless the tax (charge) is reasonably related to the cost of a benefit, service, or regulatory effort provided to the payor.</p>
<p>Impact Fees</p>	<p>Cities and counties have the inherent constitutional authority to adopt impact fees. Under the Mitigation Fee Act (the fees charged have to be reasonably related to the purpose for which the fee is charged. Impact fees are generally associated with new development activity. Impact fees would have limited utility in the Delta Primary Zone, but may be more applicable in the Secondary Zone where urban development is occurring.</p>	<p>Special districts do not have the inherent authority to adopt impact fees and must rely on specific legislative authorization. If a district is authorized to adopt impact fees, it must follow Mitigation Fee Act. Impact fees would have limited utility in the Delta Primary Zone, but may be more applicable in the Secondary Zone where urban development is occurring.</p>	<p>The Mitigation Fee Act applies only to local agencies. State impact fees, if enacted, may require a 2/3rds vote in the legislature pursuant to Proposition 26.</p>
<p>New or Increased Property-Related Fees and Charges</p>	<p>Property owners must be notified of the proposed charge, given the right of protest (the measure may be terminated by majority protest.) The fee must be reasonably related to service being provided and not for general governmental purposes. The burden is on the agency to correlate fees/charges to service costs. Fees/charges (other than water, sewer</p>	<p>Same as cities and counties.</p>	<p>Proposition 218’s limitations on property-related fees and charges do not apply to the State, although would apply to a state created regional agency New state imposed charges are limited by Propositions 13 and 26.</p>

Revenue Option	Cities and Counties	Special Districts	State of California
	<p>or solid waste disposal charges) must be approved by the voters (property owner or registered voter.) (Proposition 218.)</p>		
<p>Regulatory Charges</p>	<p>Restricted to the reasonable costs of providing the service or activity; cannot be used for general revenue purposes. The burden is on the agency to correlate fees/charges to service costs..</p>	<p>Same as cities and counties.</p>	<p>Same as cities and counties.</p>
<p>User Fees</p>	<p>User fees are restricted to the reasonable costs of providing the service or activity; cannot be used for general revenue purposes. Depending on the specific imposition, a user fee may also fall under Proposition 218 (see Property-Related Fees and Charges, above.)</p>	<p>Same as cities and counties.</p>	<p>New state-imposed taxes require a 2/3rds vote of both legislative houses unless the tax (charge) is reasonably related to the cost of providing the benefit, service or regulatory effort. Under Proposition 26, revenues cannot be used for general revenue purposes.</p>