

#36.35

10/5/70

Memorandum 70- 114

Subject: Study 36.35 - Condemnation (Interim Financing for the Condemnee for Relocation)

SUMMARY

This memorandum presents several alternative schemes for making funds available to the condemnee to finance his relocation prior to actually receiving the condemnation award. The schemes in general run into difficulties, where state involvement is concerned, from constitutional limitations on the state's ability to contract debts and on the state's ability to lend its credit for private purposes. The staff feels that only limited measures encouraging private funding are feasible. The Commission should determine whether it wishes to further pursue any of the schemes presented.

ANALYSIS

At the September meeting, the Commission directed the staff to investigate the possibility of making the credit of the state available in order to enable businesses whose property had been condemned to relocate before the final condemnation order and award. The basis of this notion was a felt need to provide some sort of interim financing for the period between the commencement of eminent domain proceedings and their conclusion. The staff has considered several possible means of interim financing, each of which appears to have serious practical, political, or constitutional drawbacks.

Advance deposit of probable just compensation upon demand of property owner. In the staff's opinion, the simplest and best solution to the finance problems of the condemnee is to require advance deposit of probable

just compensation in all cases before the condemnor can initiate acquisition proceedings. At present, California has no such provision. The Commission has determined to enact a limited advance payment requirement: a residential owner may demand a deposit even though the condemnor does not necessarily wish to take advantage of its option to deposit and early possession. See proposed Comprehensive Statute Section 1269.05. The Commission has indicated that, although expansion of this right is desirable, the proposed section as limited is all that is politically feasible at present and, in fact, may be more than is politically feasible. See Tentative Recommendation and a Study Relating to Condemnation Law and Procedure--No. 1: Possession Prior to Final Judgment 1101, 1112 (1967).

Providing interim financing assistance as a form of relocation assistance. The condemnee's cost of acquiring substitute property could be financed to a very limited extent through relocation allowance payments. See Recommendation Relating to Condemnation Practice and Procedure: Relocation Assistance (Sept. 24, 1970) §§ 7263, 7264 (supplementary payment to finance replacement dwelling in a decent, safe, and sanitary condition). However, generally relocation allowances extend only to moving expenses, whereas the condemnee needs the award money early not because of the expense involved in moving (necessarily) but because of the cost of acquiring new property before money is received for the condemnee's equity in the old property. Even if the concept of moving expenses were broadened to include a provision for interim financing of the cost of acquiring substitute property, there would be difficulties in making the money available before or immediately after the move. If the money is to be paid before the move,

there must be prior agreement or some procedure for determining the amount of in lieu payments; if the money is to be paid after the move, there must be sufficient advance notice of the move so that the condemnor will have the actual and reasonable amount on hand. The objection to requiring the condemnor to deposit the estimated amount of just compensation upon demand of the condemnee in all cases are fully applicable here. Suppose the condemnee moves, and the condemnor subsequently desires to abandon? Once the condemnee has substantially and irreversibly changed his position in justifiable reliance upon the condemnation proceeding, the condemnor can no longer abandon. Code Civ. Proc. § 1255a(b).

Borrowing against anticipated condemnation award. The condemnee, if he is fortunate, may be able to obtain funds by borrowing against the anticipated condemnation award. This possibility is described in 7 Nichols, Eminent Domain § 3.06:

In jurisdictions wherein no advance payment machinery has been established, the condemnee may be able to obtain interim financing from a lending institution. Where the property is not heavily mortgaged, it may be possible to obtain a loan on the strength of an assignment to the bank of the condemnee's rights in the ultimate award. When the award is eventually paid, the assignee repays itself and turns the balance over to the borrower. [Footnote omitted.]

The major problem with such a scheme is that the banks may be unwilling to lend sufficient money on the anticipated condemnation award. The state may decide to abandon the proceedings, and no money will be forthcoming. Or, the state may be able to force a low valuation on the property, making it inadequate security for a relocation loan. If the condemnee defaults on the loan, the bank will have as security a right that can be reduced to cash only after settlement or litigation of a disputed amount--the "fair market value" of the property. For these reasons, when banks do make relocation

loans, they rely more on the credit of the person with whom they are dealing than on the probability of an adequate award on the property. See 7 Nichols, Eminent Domain § 3.06, listing as factors the age and earning capacity of the condemnee as well as his personal credit rating. Bank loans could, of course, be encouraged by making explicit statutory provision for the assignment of prospective proceeds much in the manner that a tort judgment against a public entity is assignable or can be used as security for a loan:

Govt. Code § 971.2. Tort judgments as legal investments or security

971.2. (a) All tort judgments for which a local public entity is liable are legal investments for all trust funds, and for the funds of all insurance companies, banks (both commercial and savings) and trust companies, and for every other local public entity within this State, to the same extent as bonds of the local public entity liable for the tort judgment.

(b) Whenever any money or funds may by law be invested in or loaned upon the security of bonds of a local public entity, such money or funds may be invested in or loaned upon the security of a tort judgment for which such local public entity is liable; and whenever bonds of a local public entity may be used as security for the faithful performance or execution of any court or private trust or of any other act, a tort judgment for which such local public entity is liable may be so used.

(c) All tort judgments for which a local public entity is liable, to the same extent as bonds of such local public entity, are legal for use by any state or national bank or banks in the State as security for the deposit of funds of any local public entity within this State.

Applied to a prospective condemnation award, however, such a provision would be extremely weak for the simple reason that the amount is uncertain, not yet having been reduced to judgment. As a consequence, while lenders could be alerted to the possibilities of making loans based on a prospective award, they would probably still look to the personal credit of the condemnee when making a loan. The only real benefit probably would be a better interest rate on the loan since there would be some security for its repayment.

Lending the credit of the state; incurring state debt. Because the person or business which most needs a relocation loan will usually be the one with a low credit rating, some way could be sought whereby the state gives assurance that an award of adequate amount will be made. Such a proposal has two general and major problems: an assurance would cut down on the condemnor's flexibility to acquire or abandon and virtually fix a minimum price without trial; and an assurance would entail the state's lending its credit to aid a private person:

The Legislature shall have no power to give or to lend, or to authorize the giving or lending, of the credit of the State, or of any county, city and county, city, township or other political corporation or subdivision of the State now existing, or that may be hereafter established, in aid of or to any person, association, or corporation, whether municipal or otherwise, or to pledge the credit thereof, in any manner whatever, for the payment of the liabilities of any individual, association, municipal or other corporation whatever. [Cal. Const., Art. XIII, § 25 (formerly Art. IV, § 31).]

These obstacles are not insurmountable, however. For even if the state were to guarantee a certain amount of award on the property, that guarantee could be conditional upon acquisition of the property; the lender could protect itself by making use of the property itself as security (if it is not already overmortgaged) in case of condemnor abandonment. Further, the possibility of condemnor abandonment is slim in view of the condemnee's reliance, mentioned above.

Thus, the state could either post a litigation bond as surety for any judgment entered or could issue a note, fully negotiable, promising to pay the amount awarded. These instruments could either be made out in the amount of estimated just compensation or in future terms of the award itself. In the latter case, the only function the instrument would serve would be to assure the lender of the state's solvency, but it would give

no indication on the amount the state was good for. If the instruments are made out in a definite face amount, however, the lender by proper discounting, could assure itself a handsome profit. If the instrument were merely a surety bond, there probably would be no constitutional problems of lending the state's credit, for it would be simply holding itself out as willing to make good its debts. However, suppose the award came to less than the face amount of the bond; would the condemnor be obligated to make good its full face value? Apparently it would. Such a result is plainly undesirable, for the condemnor should not be required to pay more than the property is actually worth, particularly since it is assuring payment solely for the condemnee's benefit. Further, it would have the effect of making the condemnor conservative on its estimates of probable just compensation, to the detriment of the condemnee.

The case of some sort of negotiable note or instrument presents the same problems as the case of a litigation bond, with an added constitutional dimension:

The Legislature shall not, in any manner create any debt or debts, liability or liabilities, which shall, singly or in the aggregate with any previous debts or liabilities, exceed the sum of three hundred thousand dollars (\$300,000), except in case of war to repel invasion or suppress insurrection, unless the same shall be authorized by law . . . ; but no such law shall take effect unless it has been passed by a two-thirds vote of all the members elected to each house of the Legislature and until, at a general election or at a direct primary, it shall have been submitted to the people and shall have received a majority of all the votes cast for and against it at such election [Cal. Const., Art. XVI, § 1.]

This provision requiring extensive approvals of state indebtedness is extremely important for several proposals to be discussed below; does it bar the state from issuing a promissory note to pay the award

when it comes due? The issuance of a promissory note is technically the creation of a liability or indebtedness, a promise to make payment at some future date. The constitutional section quoted immediately above is addressed not only to bonded indebtedness, but precludes expenditures unless the funds to cover the expenditures are either already available or are soon to become appropriated. However, a promise to pay money not presently appropriated, but for which an appropriation is anticipated, is not a "debt" within the meaning of Article XVI, Section 1. See, e.g., State v. McCauley, 15 Cal. 429 (1860). The California Supreme Court has stated:

It is well-settled in this state that revenues may be appropriated in anticipation of their receipt just as effectively as when such revenues are physically in the treasury. The appropriation of such moneys and the issuance of warrants in anticipation of the receipt of revenues in effect operate in the nature of a cash payment, and therefore do not create an indebtedness or liability within the meaning of the debt limitation clause. [Riley v. Johnson, 219 Cal. 513, 27 P.2d 760 (1933).]

Thus, issuance of a negotiable instrument, promising to pay the costs of a condemnation award if the proceeding is not abandoned, would probably be constitutional under both the lending credit and the debt provisions. But it would probably not be sufficient inducement for a private lender to make a loan, regardless of its negotiability, unless it specified a face value.

Insurance of loan to property owner. If the state is unable to induce the private lenders to make loans by simply assuring them that its credit is good, perhaps it can do so by insuring the loan. Systems of federal loan insurance are commonplace and remarkably successful. A system of loan insurance for the condemnee might consist of the condemnor appraisal of probable just compensation which the condemnor reveals to the condemnee. Condemnee goes to the lender of his choice with the estimate and takes out a loan.

The amount of the loan is the estimated value discounted by a percentage taken out and paid to the state which maintains a fund. In the event that the condemnee defaults on the loan, the condemnor-insurer makes up the difference from the insurance fund. The systems normally work quite well, with the condemnee essentially paying the cost of the insurance fund and its administration by taking a discounted loan. The big problem here, however, is the limitation on the state lending its credit on behalf of a private party, which it would appear to be doing most directly in this case. The problem has never directly come up in California, although in Veteran's Welfare Board v. Jordan, 189 Cal. 124, 208 P. 284 (1922), a scheme was held unconstitutional whereby the state purchased homes on behalf of veterans and then resold to them on liberal terms. In other jurisdictions with comparable constitutional restrictions, state plans to insure home loans have been invalidated. See Annot., 98 A.L.R. 1367 (1935). Presumably, then, a relocation loan insurance program would be held unconstitutional in California.

State going into lending business. If the state is unable to encourage loans by private lenders, perhaps then it could go into the lending business itself. Setting aside for a moment the cries of outrage from the private lenders, such a plan would seem eminently feasible. The state, say, sets up a loan fund financed by 6% general obligation, long-term bonds. The bonds, while not necessarily easily marketable, may be desirable investments because of their stability and their tax-free interest. The state then makes loans from this fund to a condemnee who needs emergency relocation assistance. The loan could be at 7%; this would be advantageous to the condemnee, who gets it below the prime rate; and advantageous to the state, which is able to pay administration costs and interest on the indebtedness. A somewhat similar

program is available to finance purchases of low-cost homes by California veterans. Everyone is happy but the lenders who were not going to make a reasonable loan anyway. The flaw in this plan is that the loan fund will have to be financed by a bond issue, which requires election, and so forth. Since this bond issue is designed to make money--rather than to put the state further into debt--and does not need to be financed out of tax money, it might stand some chance of passage. However, the political implications of a state bank might be too overwhelming for passage.

Use of revenue or special assessment bonds. A similar system might be set up by avoiding the constitutional requirement of an election. This could be done by issuing either revenue or special assessment bonds rather than general obligation bonds. A revenue bond is one which pays its own way through the generation of income on the improvement that it finances. A revenue bond is not subject to the constitutional debt limitation. Oxnard v. Dale, 45 Cal.2d 729, 290 P.2d 859 (1955). Since the relocation bonds are designed to pay their own way, they may qualify as revenue bonds although, it is unusual for revenue bonds to be based on loans for the generation of their income.

Alternatively, special assessment bonds, payable from assessments on property benefited by the condemnor's activity and improvements, could constitute the loan fund. Special assessment bonds, like revenue bonds, are not subject to the debt limitation imposed on general obligation bonds. Annot., 164 A.L.R. 604. The problem here is that, if special benefits to property are to be assessed, there may be other needs for the money--a relocation loan fund is not necessarily the only or most deserving cause.

Private condemnation insurance. A final means by which interim financing for relocation purposes might be made available, is private condemnation insurance. A statute could authorize companies to make such insurance available to people who wish to purchase it. The insurance could take the form of nominal premiums with the pay-off being a low-interest or interest-free loan in case of condemnation; or it could be high premiums, with a recovery of expenses and loss in case of condemnation. Obviously, there would not be much of a market for the latter. But if condemnation insurance of the former type were offered at, say, \$.50 per annum extra in a homeowner's or renter's policy, it might well become a standard and valuable aid to the condemnee.

Conclusion and recommendations. The Commissioners may well be able to come up with other and better means of interim financing. Of those presented above, the staff feels that the only feasible ones are the limited ones of specifying that a prospective award is fully marketable and--possibly--of specifying that condemnation is an insurable risk. (Of course, the best overall solution is expansion of the requirement of advance payment.) The Commissioners should review the various schemes and determine whether any of them is worth further investigation and elaboration. Attached are draft copies of statutes making the judgment proceeds prospectively assignable, and authorizing private condemnation insurance.

Respectfully submitted,

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EXHIBIT I

Eminent Domain Code § . Assignment of Condemnation Judgment

(a) At any time after a condemnation action has commenced, the condemnee may assign all or part of his interest in the final judgment, regardless whether such judgment has been rendered. Such a transfer may be absolute or for purposes of creation of a security interest.

(b) The transferee may perfect its interest in the final judgment by giving written notice of the transfer to the condemnor. Upon the condemnor's receipt of notice of transfer,

(1) The transferee may move to set aside any abandonment as provided in Code of Civil Procedure Section 1255a(b);

(2) The condemnor shall not settle the litigation without the transferee's consent; and

(3) After judgment or settlement the condemnor shall pay the condemnee's transferred interest directly to the transferee.

(c) An interest in a condemnation judgment is adequate collateral as security for a loan and is a legal investment for the funds of all commercial and savings banks.

Comment. This section is intended to make a condemnation judgment, or a prospective judgment, fully marketable. The right to payment of such a judgment or expected judgment is a general intangible within the meaning of Cal. Com. Code § 9106, and is a transferable chose in action. Cal. Civil Code § 954. Once a condemnation action has commenced by filing, the prospective

judgment is more than a mere possibility and is coupled with an interest, thus escaping the antiassignment requirement of Cal. Civil Code § 1045.

Subdivision (b) allows a transferee of the interest to perfect it, which is to make it good or fully effective against third parties within the meaning of Division 9 of the California Commercial Code. Perfection of the transferee's interest in the right to payment is accomplished by notification of the condemnor, whether the transfer is absolute (Cal. Civil Code § 955.1) or for security only (Cal. Com. Code § 9302(1)(g)). Once the transferee has notified the condemnor, the transferee steps into the place of the condemnee so far as the transferred interest is concerned. Since the condemnor may not abandon the condemnation proceedings if the condemnee has substantially changed his position in justifiable reliance on them, the transferee which has invested in the proceedings is also entitled to move to set aside the abandonment. Code Civ. Proc. § 1255a(b).

Subdivision (c) merely specifies that the interest in the judgment is a proper form of security for any lender, and authorizes certain institutional lenders to purchase the condemnee's interest in the judgment.

EXHIBIT II

Insurance Code § 120. Miscellaneous

120. Miscellaneous insurance includes insurance against any loss, direct or consequential, caused by condemnation or threat or imminence thereof, or insurance against loss from damage done, directly or indirectly by lightning, windstorm, tornado, or earthquake , or insurance under an open policy indemnifying the producer of any motion picture, television, theatrical, sport, or similar production, event, or exhibition against loss by reason of the interruption, postponement, or cancellation of such production, event, or exhibition due to death, accidental injury, or sickness preventing performers, directors, or other principals from commencing or continuing their respective performance or duties; and any insurance not included in any of the foregoing classes, and which is a proper subject of insurance.

Comment. This section makes clear that the risk of loss due to exercise of the eminent domain power is an insurable risk and that any loss caused is compensable. Although any type of loss resulting from condemnation is insurable, it is contemplated that condemnation insurance will be directed primarily towards those items of loss which the condemnor does not cover, such as certain items of relocation expense and towards early payment of costs and expenses through loans or otherwise. "Threat or imminence" of condemnation is defined in Eminent Domain Code Section .