First Supplement to Memorandum 79-28

Subject: Study E-200 - Special Assessment Liens on Property Acquired for Public Use (Additional Comments on Tentative Recommendation)

Since Memorandum 79-28 was written analyzing comments received on the special assessment lien tentative recommendation, we have received several additional comments. The additional comments are analyzed in this supplementary memorandum.

Classification of Assessment Liens

The tentative recommendation classifies special assessment liens as being of two types--"fixed lien special assessments" which are in fixed amounts imposed for a capital expenditure, and "special ad valorem assessments" which are imposed annually for maintenance and operations of a special assessment district. Ms. Peggy McElligott (Exhibit 1) notes that there is a common type of assessment that does not fit either of these categories--it is imposed for capital expenditures rather than general district purposes, and is imposed annually not based on any fixed amount. This is also the concern of Professor Sho Sato (see Exhibit 5 to Memorandum 79-28); the staff misunderstood his point in the prior memorandum, but Professor Sato has explained it orally to the staff.

The staff proposes to remedy this problem by revising the definitions to encompass the intermediate type of special assessment described by Ms. McElligott and Professor Sato and to eliminate other ambiguities in the definitions noted by Ms. McElligott.

(a) As used in this section:

(1) "Fixed lien special assessment" means a nonrecurring assessment ~~in a fixed amount~~ levied on property in a fixed amount by a local public entity for the capital expenditure for a specific improvement, whether collectible in a lump sum or in installments.

(2) "Special ~~ad valorem~~ annual assessment" means a recurring assessment in an indeterminate amount levied annually by a local public entity ~~other than for the capital expenditure for a specific improvement, whether fixed on the basis of the value of the property assessed or on some other basis~~ , whether for the capital expenditures for a specific improvement or for other purposes .

This revision in effect treats the intermediate type of assessment as an annual tax-like assessment even though it may be imposed in whole or part to recoup the cost of a capital improvement. Professor Sato was originally concerned that such treatment would create a windfall for the property owner, since the owner would receive the benefit of the improvement in the eminent domain award without the burden of paying future assessments. Professor Sato has informed the staff that upon further consideration it appears there may be no windfall since the burden of future assessments would be taken into account in determining the fair market value of the property taken.

Ms. McElligott is concerned with another facet of this problem. If the share of the cost of the improvement that should be borne by the property being condemned is not paid off in the eminent domain proceeding, the acquiring entity may be exempt from paying future assessments thereby removing the property from the assessment roll and shifting the burden of the future assessments to the remaining private owners. The problem with paying off the share allocable to the property taken is that the share is not fixed; it is unknown and is reassessed annually by the improvement district; no lien has yet arisen for future assessments. To overcome these problems, Ms. McElligott proposes that the proportionate share assessed to the property being taken be determined and applied to the remaining total debt obligation due for the improvement to derive a total amount allocable to the property being taken; this amount would have to be paid by the condemnor in the eminent domain proceeding.

The staff does not feel very comfortable with such a scheme. To require the satisfaction of liens not yet imposed but anticipated to be imposed in the future is not satisfactory, particularly where the amounts to be imposed in the future are variable. A district has available a number of assessment options and could impose a fixed lien type assessment if it is concerned about future decreases in the assessment base. Whether a public entity that acquires property is liable for future assessments on the property is determined by the statute under which the assessments are imposed. If removal of property from the assessment base by a public entity is a problem, the staff believes the problem should be dealt with directly. The Commission should decide whether it wishes to study the problem of the exemption of public property from special assessments, with the view to proposing corrective legislation. If so, the staff believes this should be undertaken as a separate study.

Payment of Bondholder

Section 1265.250(b)(1) of the tentative recommendation provides that holders of bonds securing special assessment liens are paid off when the property subject to the liens is taken by eminent domain. Professor Gideon Kanner (Exhibit 2) points out that bonds are commonly discounted on the market and to pay off a bondholder in the full amount of the lien at the time of taking results in a windfall to the bondholder from early payment. He suggests that the bondholders receive only fair market value (discounted value) for the bonds.

The tentative recommendation recognizes this problem to a limited extent. Section 1265.250(b)(1) permits the condemnor to withhold from the award the amount due the bondholder pursuant to Section 1265.220, which provides:

> 1265.220. Where property acquired by eminent domain is encumbered by a lien and the indebtedness secured thereby is not due at the time of the entry of judgment, the amount of such indebtedness may be, at the option of the plaintiff, deducted from the judgment and the lien shall be continued until such indebtedness is paid; but the amount for which, as between the plaintiff and the defendant, the plaintiff is liable under Article 5 (commencing with Section 1268.410) of Chapter 11 may be deducted from the judgment.

As the preliminary part of the tentative recommendation points out, "It may be advantageous to the condemnor to permit the lien to remain on the property and withhold an amount from the award sufficient to pay off the obligation of the lien as it comes due. This option is available to the condemnor in the case of a general lien, and should be available in the case of a fixed lien special assessment as well."

However, regardless whether the full amount of the lien is paid immediately to the bondholder or withheld for later payment, in either case the amount left the property owner when the award is apportioned is less than the property owner's fair share. The staff recommends that Professor Kanner's suggestion be implemented by revising Section 265.250(b)(1) to read:

> (1) The ~~amount~~ fair market value of the lien shall be paid to the lienholder from the award or withheld for payment pursuant to Section 1265.220.

Apportionment of Assessment Obligation in Partial Taking

If property is encumbered by an assessment lien and the property is subdivided or otherwise split, it may be useful to the parties to apportion the obligation of the assessment lien among the divided parcels. Depending upon the statute pursuant to which the assessment lien was imposed, there may be a statutory procedure pursuant to which this is accomplished.

Memorandum 79-28 contains a proposal to permit court apportionment of the obligation of the assessment lien among the divided parcels in cases where there is no applicable statutory procedure. A letter from Mr. Robert Brunsell (Exhibit 3) indicates that apportionment may be a problem even where there is an existing statutory procedure. This is the case, for example, under the Improvement Act of 1911, pursuant to which consent of the improvement bondholder is required to apportion the assessment. See Sts. & Hwys. Code § 6483. The bondholder may be unwilling to consent to the apportionment or may consent only upon payment of substantial additional charges.

The question posed by this situation for the Commission is whether to amend the statutory apportionment procedures or to provide an additional means of apportioning the obligation of the lien apart from the applicable statutory procedures. The staff is not inclined to deal with this problem. The statutory procedures were designed to protect the bondholder and should be changed or avoided only with circumspection. The parties to a transaction, if they are unable to obtain the consent of the bondholder, have the available option of paying off the bond rather than dividing its obligation. Moreover, the apportionment difficulty appears to have arisen infrequently in practice and to have been ordinarily resolved by the parties to a transaction. See Exhibit 4 of Memorandum 79-28. If the apportionment procedure under the Improvement Act of 1911 is inadequate, there is a professional association of the assessment bond industry that is in a position to sponsor any needed corrective legislation.

If the Commission wishes to pursue this matter a nonetheless, the staff will investigate the issues and policies involved and will come up with proposals. In any event, we would not postpone introduction of our basic legislation but would deal with the apportionment problem as a separate matter.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

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August 15, 1979

State of California
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

RE: Tentative Recommendation - Special Assessment Liens on Property Acquired for Public Use

ATTN: Mr. Nathanial Sterling, Assistant Executive Secretary

Dear Mr. Sterling:

I must apologize for not having gotten comments in on your Tentative Recommendation on Special Assessment Liens by this time. As I am sure you know, I had a telephone conversation with John DeMoully relating to my concerns and he suggested, since the meeting of the Commission has been postponed to September, that I send my comments in as soon as possible.

My primary concern over the draft amendments to the Code of Civil Procedure section 1265.250 is the definition of "fixed lien special assessment" when combined with the definition of "special ad valorem assessment".

The definition of "special ad valorem assessment" excludes, by its own terms, a levy for capital expenditure. On the other hand, "fixed lien special assessment", by its terms, relates to a capital expenditure with a fixed amount.

It is extremely common, or at least it was up until the adoption of Proposition 13, for charter cities to conduct assessment proceedings which result in a payback of a fixed total capital amount but the levy of an individual amount not ascertainable as to any particular property. This particular approach was challenged several years ago by Alpha Beta stores in its attempt to overturn an assessment proceeding for parking by the City of Whittier. (Alpha Beta Acme Markets, Inc. v. City of Whittier, et al, 262 CA2d 16). Following this type of procedure, a charter city will frequently determine the actual cost of the particular capital improvement and make a determination that benefit is more adequately represented by an annual re-evaluation of relative benefits rather than a one-time distribution of the total costs without the ability to reflect change of facts. This approach has been particularly valuable when dealing with commercial and redevelopment areas where changes of land use or extent of use are taking place.

The type of assessment described does not appear to be covered by either of the two definitions and thus leaves open the question as to what happens to the future payment. If it is your intent, it should be made clear, whether the assessment is payable by annual ad valorem levy or by some other annual determination of benefit, that the land being acquired by the public agency will be immune from future levies. Before taking such a position, however, I would appreciate your consideration of the remainder of my comments.

Additional questions are raised by the use of the term "ad valorem" in section (a) (2). Your reference calls for "an indeterminate amount levied annually" for other than a specific capital expenditure "whether fixed on the basis of the value of the property assessed or on some other basis." This would present the only definition in California Law of which I am aware which terms an annual levy on a basis other than assessed value as an ad valorem levy. I question whether that confusion should be suddenly written into the law. "Ad valorem" in its Latin derivation connotes a relationship to value. To open up the definition so that it would refer to an annual allocation based on square footage or on area adjusted by land subject to irrigation, as may well be the instance with an irrigating entity, creates a confusion for which I can see no reason.

If, indeed, the intent is to exclude the property from having to pay for future allocations, and to provide only for an allocation as to that which is a current lien, I would suggest the change of the reference from "special ad valorem assessment" to "special annual assessment". That at least would further the intent of the language, leaving open, again, the question of what occurs with a levy for repayment for capital cost.

Your definition in section (a) (1) in referring to a "fixed amount" needs clarification. Is it intended to relate to the capability to determine the cost of the capital improvement in total or must it be possible to determine the allocation of that cost in its relationship to a particular parcel of land? I would suspect that the intent of the present drafting is to provide the second alternative. If my assumption is correct, I do feel that there should be provision for what occurs with assessments which may not be ascertainable as to the particular parcel but which are allocated in some fashion on an annual basis.

Under any circumstances, the problem can be significant if a major portion of the property subject to this annualized assessment levy, whether ad valorem or otherwise, is converted from private to public property. At some point it is very possible for the burden of debt repayment to become oppressive on the lands which remain in private ownership. Remember, that the shifting burden of the annual debt repayment goes not only to the property owner from whom the land is acquired in the eminent domain action but to all other lands which have had a determination of benefit made.

Except where the land area being acquired is minimal, I would suggest consideration of a specific factor applicable to an acquisition, providing for a payment to the public agency having such an unascertainable assessment of a percentage of the total remaining debt obligation equal to the proportion which the current year levy against the particular property being acquired bears to the total levy for the year for the purpose of repaying the debt. This then could, in effect, provide a means for reimbursing the affected public agency and remaining private property owners with a fair compensation for the removal of the property from private ownership.

I would also suggest that the kind of factored allocation provided for above should be applicable to acquisition by means of negotiated purchase or gift as well as by eminent domain. The manner of acquisition should not, in and of itself, be the determinent. Enforcement of collection against public agencies in later years has become difficult since there is no longer available the right to mandate the levy of taxes. When land becomes publicly owned it is immune from foreclosure. Prior to the adoption of Proposition 13, the security for assessments on public land was the right to insist upon a levy of taxes, enforceable in a court of law, sufficient to pay the annual obligation. Even if a public agency would like postpone payments and rely on its annual budgeting, Proposition 13 has taken the power to levy such a tax, and thus the enforcement tool, away from all public agencies. Consequently, it would appear more appropriate to handle the matter at the front end, at the time of acquisition.

Please let me know if you have any questions concerning these comments or if there is any further information which I can provide to you.

Very truly yours,

Peggy L. McElligott
WILSON, MORTON, ASSAF & MC ELLIGOTT

PLM/mp

LOYOLA LAW SCHOOL

Professor Gideon Kanner
(213) 642-2951

August 27, 1979

California Law Revision Commission
Stanford Law School
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Re: Study E-200
Special Assessment Liens, etc.

My apologies for not addressing you on this matter sooner; I recently returned from a lengthy vacation, and found the most recent memorandum on the above subject waiting.

I am critical of the tentative recommendation in one respect; namely, its proposal that bonds securing special assessment liens be simply paid off (at least in the case of a total take). This is unfair in many situations because often such bonds are traded in the market at a considerable discount. It strikes me as shocking that a municipal improvement bond trader should be able to pick up his paper in the market at a substantial discount, and then - if the property securing his bonds should happen to be condemned - get paid 100 cents on the dollar. These interests have a market, and therefore I see no reason why their owners should not be paid fair market value, the same as other owners of interests in the condemned property. Particularly in view of the U.S. Supreme Court's recent reiteration of the market value criterion as a measure of just compensation of properties for which there is a market (U.S. v. 564.54 Acres (1979) 99 S. Ct. 1854), I see no reason why the law should treat a bond speculator more generously than anyone else, or at least more generously than the market would.

Sincerely yours,

Gideon Kanner

Gideon Kanner
Professor of Law

EXHIBIT 3

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July 16, 1979

Mr. Nathaniel Sterling
Asst. Executive Secretary
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Stanford Law School
Stanford, Ca. 94305

Re: Your Memorandum 79-28 dated 6/15/79

Dear Mr. Sterling:

It appears to us that your proposed addition of Section 53939 to the Government Code will not necessarily resolve the problem raised by the Southern California Edison Company. Although it is not clear from the letter of Mr. Homer, it appears that he may have been dealing with a bond issued under the Improvement Act of 1911. There is a statutory procedure for the division of such a bond, but that procedure requires the consent of the bondholder. This type of bond is issued on the basis of a separate bond for each separate assessed parcel of land. The bondholder's consent is required so that he may protect his security interest in the property.

The proposed new section would not appear to apply to a 1911 Act bond, inasmuch as there is an "applicable statutory procedure for apportionment of the lien".

Very truly yours,

STURGIS, NESS & BRUNSELL
a professional corporation

Robert Brunsell

Robert Brunsell

RB:mr

cc: Scott Clinton, Stone & Youngberg