
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: # 330

Proposed Ordinance Amending the Municipal Code to Authorize Special Tax Financing for “Conservation Improvements”

OVERVIEW

In an effort to provide property owners in the City with a innovative option to finance renewable energy, energy efficiency retrofits and/or water conservation fixtures (Conservation Improvements), the Mayor is proposing a property owner financing mechanism whereby loans are tied to the improved property and loan repayment is facilitated with a special tax levy on the annual property tax bill. The first step in developing the contemplated financing program requires amending the City’s Municipal Code to 1) provide Charter City authority for the proposed financing mechanism and 2) incorporate by reference useful elements of existing State law. Additional City Council actions will be required before the proposed financing mechanism will become available to eligible property owners in the City.

This report provides a brief overview of the proposed Clean Generation financing program, associated benefits and limitations, and explains the reason for the proposed ordinance. Additionally, we discuss recently proposed changes to Appendix A of the City’s Debt Policy as they relate to the contemplated financing program.

FISCAL/POLICY DISCUSSION

Overview of the Contemplated Clean Generation Financing Program

The proposed ordinance proclaims the installation of Conservation Improvements on private property in the City to be in the public interest “in furtherance of the public health, safety, and

general welfare in that such installation will help conserve valuable natural resources and address the issue of global climate change". Specifically, the proposed ordinance provides that special district financing may be used to finance "the acquisition, construction, expansion, installation and improvement of energy efficiency, water conservation, including pollution control, and renewable energy improvements and equipment with an expected useful life of five years or longer to or on real property and in buildings, whether such real property or buildings are privately or publicly owned." A staff report from the Environmental Services Department to the Natural Resources and Culture Committee dated November 20, 2009 indicates that examples of Conservation Improvements include: insulation, heating and cooling systems, whole house fans, hot water heaters, windows, doors, pool pumps and solar thermal water systems, solar (photovoltaics), wind, hydrogen as well as drought tolerant plants, reclaimed water systems and water efficient irrigation.

Property owners interested in installing Conservation Improvements could apply for financing that will be legally tied to their property. This financing feature is unique in that the responsibility to repay the debt stays with the property rather than with the property owner who initially opted to improve their property by installing conservation improvements. Property owners who subsequently purchase a property with financed conservation improvements would enjoy the beneficial value/use of the improvements and repay the remaining term of the debt with their annual property tax payments.

Following the issuance of a RFP last June, City staff is in the process of recommending an experienced program team to administer the lending program and provide the related financing. Staff anticipates bringing these agreements to the City Council for consideration in March 2010. Loan terms for Conservation Improvements are expected to be up to 20 years. Staff has indicated the all-in interest rate for a twenty year loan would be determined by the rate on a 20-year Treasury Bond plus 245 basis points (2.45%), or approximately 7% based on today's rates. With the exception of certain start-up costs (i.e., promotional brochures), all costs related to program administration, financing and City staff time would be covered by the aforementioned interest rate on Conservation Improvement loans.

Benefits and Limitations of the Financing Program

The creation of similar financing programs in Berkeley and Palm Desert has resulted in substantially increased installations of Conservation Improvements. Based on IBA discussions with staff and review of provided background information, the proposed Clean Generation financing program additionally offers, but is not necessarily limited to, the following benefits:

- Alternative source of financing for Conservation Improvements that is tied to the property and repaid by the beneficial owner(s)/user(s) of the improvements.
- Creates an incentive for property owner investment in Conservation Improvements.
- Supports the environment (reduction in green house gases) and the region (by reducing the demand for limited energy/water supplies).

- Supports the local economy by requiring at least one of the following: 1) equipment and materials be purchased from a point of sale within the City, or 2) 50% of equipment and materials be purchased from manufacturers located within the City, or 3) installers or contractors hired from within the County. (Although exemptions can be made if it is impractical for a property owner to meet one of these criteria.)
- City to contract with an experienced program administrator to assist City property owners with all aspects of program participation.
- Although program financing may be initially limited (\$20 million), there is potential for additional funds and there is no cost to the City's General Fund.

By adding Division 26 to the City's Municipal Code, the proposed ordinance limits eligible facilities to be financed to those described in Section 61.2611 (page 6 of the proposed ordinance). Eligible improvements for financing are limited to those types of public improvements authorized by the Mello-Roos Community Facilities Act of 1982 (Act) and other Conservation Improvements as described above and in Section 61.2611 of the proposed ordinance.

Reasons for the Proposed Ordinance

The proposed ordinance is necessary to amend the City's Municipal Code by adding new Division 26, sections 61.2601 through 61.2619 titled "Renewable Energy, Energy Efficiency and Water Conservation Improvements, and Equipment Financing Program" (Program). As stated in the proposed ordinance, the purpose of the Program is to facilitate the installation of Conservation Improvements "by providing for an alternate method to finance such improvements and equipment through the creation of special taxing districts comprised of properties to be improved and through the issuance of bonds secured by the special taxes levied on such properties." This is the first required step to establish the legal framework for the City to facilitate the desired property owner financing mechanism. The City Attorney's Office retained the law firm of Stradling Yocca Carlson & Rauth to review and comment on the form of the proposed ordinance (see attached letter dated January 20, 2010).

By amending the City Municipal Code as proposed, the City will be able to establish a unique citywide special tax district. If the ordinance is approved, the formation process for the citywide special tax district would be similar to the process for the City's existing Community Facilities Districts (CFDs) which are authorized under the Act. The proposed ordinance would incorporate the Act into Division 26 (Section 61.2606) of the Municipal Code. The proposed citywide special tax district would differ from other City CFDs in the following three key areas:

1. The citywide special tax district could finance public or private improvements as defined in Section 61.2611 whereas CFDs can only finance public improvements.
2. The citywide special tax district may be formed to consist solely of territory proposed for annexation into the special tax district in the future. This allows for property owners to voluntarily opt into (or be annexed into) the special tax district to obtain financing in the future.

3. The initial property owner election approving the rate and method of apportionment and the incurring of bonded indebtedness is not necessary until properties are ready to be annexed into the citywide special tax district. CFDs formed in accordance with the Act do these things at the time of formation.

Proposed City Debt Policy Changes related to the Clean Generation Financing Program

On January 25, 2010, the Debt Management Director proposed changes to the City's Debt Policy. After discussing the recommendations, the City Council referred the proposed changes back to the Budget and Finance Committee for further discussion. Two of the proposed changes involved amending Appendix A of the Debt Policy: the Special District Formation and Financing Policy. As explained below, one of the proposed changes to Appendix A relates to the Clean Generation financing program and the other does not.

The proposed changes to Section A3 of the Special District Formation and Financing Policy do relate to the Clean Generation financing program. The change recommended for Section A3 (A.) would allow for financing private improvements so long as they are eligible under the Act, California Streets and Highways Code, or in conjunction with the City's exercise of its authority as a Charter City. Recommended changes to Section A3 (B.) provide that "such additional eligible facilities may include, but are not limited to, renewable energy installations, energy efficiency enhancements, and water efficiency enhancements." These recommended changes to the Debt Policy are consistent with the goals and objectives of the proposed ordinance and the Clean Generation financing program.

Proposed change to the Overview Section of the Special District Formation and Financing Policy does not relate to the proposed ordinance or the Clean Generation financing program. The recommended change to the Overview would provide the City with the flexibility to utilize State joint powers authorities (JPAs) to facilitate the formation of special districts and the ensuing issuance/administration of special district debt. This proposed change does not relate to the Clean Generation financing program because citywide special tax district formation, debt issuance and administration will be performed by the City in accordance with the proposed ordinance and new Division 26 of the Municipal Code. Citywide special tax district financing, as described in this report, currently could not be facilitated by a State JPA that the City belonged to.

CONCLUSION

The IBA has reviewed the proposed ordinance that would amend the City's Municipal Code to facilitate the contemplated Clean Generation financing program. Adoption of the proposed ordinance would be the first step toward establishing an innovative and alternative source of property owner financing for Conservation Improvements that would be tied to the improved property and repaid by the beneficial owner(s)/user(s) of the improvements. Outside legal counsel has reviewed the form of the proposed ordinance and concluded it will provide a valid procedure pursuant to which special taxing districts may be formed to finance improvements and equipment under the Program that would be established by new Division 26 in the City's Municipal Code.

The City Council will be asked to take additional actions to form a citywide special tax district and approve necessary program administration/financing agreements before the Clean Generation financing program can be implemented (staff is targeting June 2010). This will allow staff time to bring more detailed information forward for City Council consideration. Considering the public and private benefits described in this report, the legal opinion supporting the intent of the proposed ordinance, and the opportunity for the City Council to consider additional information as other actions related to the formation of a citywide special tax district and the Clean Generation financing program come forward, the IBA recommends adoption of the proposed ordinance.

[SIGNED]

Jeff Kavar
Fiscal & Policy Analyst

Attachment

[SIGNED]

APPROVED: Andrea Tevlin
Independent Budget Analyst

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January 20, 2010

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Re: *Ordinance Creating the City's Renewable Energy, Energy Efficiency and Water Conservation Improvements and Equipment Financing Program*

Dear Tim:

The City of San Diego (the "City") has engaged our firm to assist in creating a program to finance renewable energy, energy efficiency and water conservation improvements and equipment (the "Program"). The Program is proposed to be implemented through an ordinance amending Chapter 6, Article 1, of the San Diego Municipal Code by adding Division 26 thereto (the "Ordinance"). We have reviewed the proposed form of the Ordinance, which is being submitted to the City Council for approval.

The Ordinance will provide for an alternate method for financing various improvements and equipment under the Program through the creation of special taxing districts. The special taxing districts will be comprised of properties to be improved with facilities of the types mentioned above, financed through the issuance of bonds secured by the special taxes levied on the included properties. The Ordinance incorporates the provisions of the Mello-Roos Community Facilities Act of 1982 (Chapter 2.5, commencing with Section 53311 of Part 1, Division 2, Title 5 of the Government Code), as amended from time to time (the "Act"), and provides that, except as expressly set forth therein, the process of forming a special tax district, approving the rate and method of apportionment, authorizing the issuance of bonds and the purposes, mode and manner of levying and collecting special taxes shall be as prescribed in the Act.

The State Legislature has enacted Chapter 29 of Part 3 of Division 7 of the Streets and Highways Code ("A.B. 811") which authorizes the financing of improvements of the type to be financed under the Program with contractual assessments. However, certain legal concerns regarding the priority of the assessment liens established under A.B. 811 have led to several public agencies and their counsel to conclude that judicial validation proceedings are necessary to implement an A.B. 811 program. By utilizing the provisions of the Act and the City's charter powers to allow the

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Program improvements to be financed with special taxes rather than contractual assessments, the major legal concerns surrounding A.B. 811 are avoided.

The Act does not currently allow the financing of improvements or equipment of the type to be financed under the Program on private property. The Ordinance allows for the Program improvements and equipment to be installed on private property and provides that the installation of these types of improvements and equipment on private property is in the public interest and in furtherance of the public health, safety and general welfare. The Ordinance also allows for certain alternate procedures from those outlined in the Act to be utilized in connection with the formation of a special taxing district, including that at the time of district formation all of the property proposed for inclusion in the district may be designated for future annexation and that the initial election approving the rate and method of apportionment and the incurring of bonded indebtedness may be held when the first properties are ready to be annexed to the district.

In analyzing whether the Ordinance is valid there are two questions to be answered: (1) is the financing of the type of improvements and equipment authorized under the Program a valid exercise of legislative power, and (2) is the levy of a special tax to pay for the improvements and equipment a municipal affair so that it can be authorized pursuant to the City's charter powers and need not conform to the general laws of the State? We believe that both of these questions can be answered in the affirmative.

Valid Exercise of Legislative Power. Article XI Section 7 of the State Constitution grants to a city the power to "make and enforce within its limits all local, police, sanitary and other ordinances." The power of municipalities to act under Article XI Section 7 is as broad as that of the State Legislature, and cities have broad discretion in exercising police power to protect the public health, safety and general welfare of the community. *Carlin v. City of Palm Springs*, 14 Cal. App 3d 706, 711 (1971). The determination of whether a law serves a public purpose lies with the legislative body and will be upheld unless it is totally arbitrary. *Community Memorial Hospital v. County of Ventura*, 50 Cal. App. 4th 199 (1996).

In enacting A.B. 811, the State Legislature declared that the financing of improvements of the type to be financed under the Program serves a public purpose and authorized local public agencies to finance such improvements through the levy of contractual assessments. The fact that the State Legislature has authorized the financing of these improvements is support for the conclusion that it is a valid exercise of the police power to do so. If the City determines that the Program serves a public purpose and is of a benefit to the health and welfare of citizens in the City, then this determination should be respected by the courts as it reflects the same intent as is expressed in state law and has not been arbitrarily determined by the Council to serve a public purpose.

Municipal Affair. In the Ordinance, the City is electing to finance the authorized improvements and equipment through a special tax rather than through contractual assessments in the manner that the State Legislature authorized in A.B. 811. Absent a conflict with state law, the courts have held that taxation is a municipal affair. The State Legislature has not declared that A.B. 811 is the exclusive method for local agencies to finance the improvements authorized in A.B. 811. Thus,

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the decision to levy special taxes to implement the Program does not conflict with state law, but, rather, is in furtherance thereof.

Sections 1 and 2 of the Charter provide that the City shall have all municipal powers authorized to be granted to municipal corporations by the Constitution and laws of the State and the right and power to make and enforce all laws and regulations in respect to municipal affairs, subject only to the restrictions provided in the Charter. Section 76.1 of the Charter provides that a special tax, as authorized by Article XIII A of the California Constitution, may be levied by the Council upon less than the entire area of the City if approved by a two-thirds vote of the qualified electors voting on the proposition in the area of the City where the tax is to be levied.

Since the Ordinance will require the approval of the special tax and the bonded indebtedness for each special taxing district by a two-thirds vote, we are of the view that, as a chartered city, the City has the authority, consistent with the powers retained by it under the Charter, to adopt the Ordinance and that, if enacted in its current form, under current law, it will provide a valid procedure pursuant to which special taxing districts may be formed to finance improvements and equipment under the Program.

Very truly yours,

STRADLING YOCCA CARLSON & RAUTH

A handwritten signature in black ink, appearing to read "Robert J. Whalen", written in a cursive style.

Robert J. Whalen

RJW:pm