



# SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY



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March 26, 1991

Transportation/Community Development and  
Budget and Finance Committees  
Sacramento, CA

Honorable Members in Session:

**SUBJECT:** RESPONSES TO QUESTIONS REGARDING THE  
HOUSING TRUST FUND

## SUMMARY

This report responds to Joint Committee questions regarding the City of Sacramento Housing Trust Fund as requested during the January 22, 1991 Transportation and Development Committee meeting. Information is also provided in this report regarding the status of the lawsuit by the Pacific Legal Foundation and the Building Industry Association.

## BACKGROUND

### HOUSING TRUST FUND BALANCE

As of January 28, 1991, after collecting Housing Trust Fund fees for approximately two years, the balance in the Fund was \$1,596,061.43. This included the processing fee of \$50 per building permit application. These funds are being held until final resolution of the lawsuit.

### RESPONSES TO COMMITTEE MEMBERS' QUESTIONS

Mr. Marc Mihaly, the attorney representing the City in the lawsuit, assisted us in preparing responses to the Committee Members' questions. His detailed responses are provided in the attached EXHIBIT A and summarized below:

1. May the City of Sacramento start spending Housing Trust Fund money prior to settlement of the lawsuit? Why? Why not?

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RESPONSE: Should the Court of Appeals or the U.S. Supreme Court rule that the Housing Trust Fund fees are invalid then the City would have no grounds for collecting the fees. Thus, the City could be subjected to returning to builders the collected funds with interest.

2. Does a statute of limitations apply with respect to spending of funds? What are the risks if the City spends the funds prior to resolution of the lawsuit?

RESPONSE: Regarding the statute of limitations for challenges to the trust fund, it appears that the time begins when each builder (potential plaintiff) pays the fee. The builder then has one year to challenge the legality of the fee. Given the fact that the entire ordinance has been sued in general, however, we do not believe it wise to begin expending funds collected over a year ago for the reasons expressed in 1, above.

3. May the City spend the interest that has been accrued, but not the principal?

RESPONSE: As noted in 1, above, we are at risk for having to return the money with interest, until the suit is settled.

4. May the City invest the funds that have been collected? Are there any limitations on the types of investments?

RESPONSE: There does not appear to be any special limitations for investing of Housing Trust Fund revenue other than normal fiduciary responsibilities of a trustee, in this case the City is the trustee. [See Item #3] The City may invest the funds through its normal money management activities, keeping a separate account of the Trust Fund revenue.

5. What is the rationale for paying the fund back to builders should the City lose the lawsuit?

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RESPONSE: The Court might order it without explicit rationale. (See 1 above)

6. May the City commingle funds collected in both the City's and County's funds?

RESPONSE: Commingling of City and County Housing Trust funds for the purpose of providing revenues to a housing project in either the City or County is apparently legally acceptable. However, for accounting purposes the funds must remain separated. Other than the need to keep separate accounting records, the major concern regarding commingling of City and County trust funds has to do with the nexus issue. Mr. Mihaly advises the City that "... the fundamental requirement is that the residents of a given project could reasonably work in the building which triggered the contribution to the account from which the funds for that project were drawn." The establishment of a zonal approach to allocation of respective City and County Housing Trust Fund revenues will, in the opinion of the attorney, address this nexus concern.

7. May we spend money collected for the City's Fund on projects in the County and vice versa?

RESPONSE: [See Item #6] Yes, provided the nexus relationship is maintained.

### STATUS OF LAWSUIT APPEAL

As you know the lawsuit by the Building Industry Association joined by the Pacific Legal Foundation challenging the constitutionality of the City of Sacramento Housing Trust Fund was rejected at the federal trial court level. The case was appealed and just heard by the Federal Ninth Circuit Court of Appeals on March 12, 1991. The City is hopeful of a positive ruling within about three to six months from the three judge panel.

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However, the possibility remains that due to the constitutional "taking" issue at the heart of the lawsuit, the case could be brought to the U.S. Supreme Court. Such a course could delay a final resolution for as long as two years, if the Supreme Court accepts the case for hearing. (Less than 2% of all Supreme Court requests are actually heard.)

### HOUSING TRUST FUND EXPENDITURE CRITERIA

While we await a final resolution of the lawsuit Agency staff is developing a set of criteria for use in evaluating allocation of Housing Trust Fund revenue to low income housing projects. This criteria will be brought forward in the late Fall or early Winter.

### RECOMMENDATION

This is an informational item and no action is requested.

Respectfully submitted,

  
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JOHN E. MOLLOY  
Deputy Executive Director

### TRANSMITTAL TO COMMITTEE:

  
\_\_\_\_\_  
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Attachment: EXHIBIT A

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EXHIBIT A

By Telefacsimile

TO: Sacramento Housing and Redevelopment Agency,  
Attn.: Deborah Belasich

FROM: Marc Mihaly and Bob Ward

DATE: February 11, 1991

RE: Questions Regarding Use of Funds in the Housing Trust  
Fund.

Our office has considered the questions you raised in your letter of February 1, 1991 regarding use of monies in the Housing Trust Fund. Below please find our preliminary responses to these questions, which we are faxing to you this afternoon in anticipation of our 4:00 meeting on February 11, 1991. We would appreciate it if you would distribute this memorandum to anyone whom you feel should receive it before the meeting. If you have any further questions or would like us to elaborate on any of our responses, please feel free to call us at your convenience.

We also wanted to mention that Ninth Circuit oral argument in the Commercial Builders case has been set for March 12, 1991 at 9:00 a.m. in San Francisco.

1. May the City of Sacramento start spending Housing Trust Fund money? What are the risks involved if we spend such funds before resolution of the Commercial Builders litigation? May we spend the interest only? What is the rationale for paying back the funds should the Housing Trust Fund be invalidated?

The Commercial Builders litigation involves a "facial" challenge to the constitutionality of a city ordinance--that is, a challenge to the ordinance's legality before it was enforced against any permit applicant. If either the Ninth Circuit Court of Appeal or the U.S. Supreme Court were to overrule the trial court and find the ordinance invalid, that would mean that the City would have no legal grounds justifying collection of fees under the ordinance.

General principles dealing with legal remedies suggest that the City would be liable for repayment of fees paid if the ordinance is invalidated. The court might require the City to pay back collected fees as part of its judgment. In Balch Enterprises, Inc. v. New Haven Unified School District, 268 Cal. Rptr. 543 (1990), for example, a court invalidated a school district resolution imposing fees on commercial developers and required a refund of fees paid.

Another source of potential liability to parties who have paid into the fund is under the concept of damages for a temporary taking. In the landmark case of First English Evangelical Church v. County of Los Angeles, 482 U.S. 304 (1987), the plaintiff alleged that the effects of an ordinance constituted a taking. Without looking at the merits of plaintiff's underlying claims, the United States Supreme Court ruled that the California Supreme Court had incorrectly held that the just compensation clause of the Fifth Amendment does not require compensation as a remedy for "temporary" regulatory taking--takings resulting from regulations which are ultimately invalidated by the court. Id. at 310. Thus, the First English court held that governments must provide compensation for the "temporary" period "during which the taking was effective." Id. at 318-322.

It is conceivable that, should the ordinance be found unconstitutional, the City would be liable for temporary takings damages to parties who have paid into the fee. It is unclear how these damages would be measured, but they might well be the amount of the fee paid plus any interest earned during the period while the money was held in trust. For this reason, there may also be risks involved in spending interest on funds received within the last year.

If the court does not require repayment as part of its judgment, parties that have paid fees will be forced to bring separate suits seeking damages under the ordinance as it affected them -- so-called "as applied" challenges. As will be explained more fully in response to question 2, below, we may have a defense to some of these claims based on the statute of limitations. Nevertheless, parties who paid the housing fee within one year before the ordinance was invalidated would have a cause of action for damages in an as-applied challenge to the ordinance. Thus, to avoid the expense of defending against such challenges, as well for obvious policy reasons, the City would

have a strong incentive for refunding monies paid into the fund before its invalidation.

2. Does the statute of limitations for challenging the legality of the Housing Trust Fund provide a basis for retaining some of the funds?

The statute of limitations for challenging the constitutionality of an ordinance is an issue that has arisen in many of our cases. While establishing the limitations period for an action is fairly straightforward, it is often difficult to determine when a cause of action accrues for a given plaintiff, or, in other words, when the time period begins to run.

Commercial Builders' facial challenge to the Housing Trust Fund was brought under both California Government Code section 66022 and the Federal Civil Rights Act, 42 U.S.C. section 1983. For constitutional challenges brought pursuant to 42 U.S.C. section 1983, a one-year statute of limitations period applies in California. For challenges brought under Government Code section 66000 et seq., any judicial challenge to an ordinance must be commenced within 120 days of the effective date of the ordinance. Government Code section 66022.

It is unclear whether all present and future parties subject to fee requirements under the ordinance are barred by the statute of limitations from challenging the ordinance's validity in an "as-applied" challenge. While the law provides no clear answer to this question, it seems unlikely that a court would bar such challenges since potential plaintiffs must first pay the fee before having standing to challenge the validity of the ordinance as it applies to their property. Thus, to be conservative, the

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<sup>1</sup> Pursuant to Government Code section 66001, the City is under an obligation to spend fees collected in the Housing Trust Fund within five years of collection. If, after five years, fees deposited in the fund have not been expended, the City may be obligated to refund unexpended fees to parties who have paid into the fund unless some acceptable use for the fee can be determined. Gov't Code section 66001(d), (e). However, within that five-year period, the City is free to spend or hold monies in the fund as it sees fit, subject only to requirement that within 60 days of the close of each fiscal year, the fund's balance be made known to the public. Government Code section 66006(b). This section could become a problem for the agency if the case goes to the U.S. Supreme Court since up to four years will have elapsed before a resolution of the issue.

City should assume that it remains vulnerable to as-applied challenges from any party asked to pay into the Housing Trust Fund for one year after such payment is made, pursuant to the statute of limitations under 42 U.S.C. 1983.

3. May we invest monies in the Housing Trust Fund? Are there limitations on the types of investments?

City Ordinance No. 89-013 says nothing about investment of monies in the fund. However, in the County ordinance, the Housing Trust Fund is described as a "special interest-bearing trust fund." County Ordinance section 16.89.300. Thus, the City should assume it is under a duty to invest fund monies.

The only limitations on types of investment relate to the fiduciary duties of a trustee. Under basic principles of trust law, a trustee is under a duty to use reasonable care and skill in making trust property productive. Witkin, Summary of California Law (9th Ed.), Trusts, Vol. 4, section 72. Under the so-called "prudent investor" rule, trustees are under a duty to invest funds in a way that reflects "reasonable diversification" to distribute the risk of loss. Id. at section 79. This "prudent investor" rule requires a trustee to investigate the soundness of each specific investment, but places no limits on the types of investment as long as reasonable diversification is achieved.

4. May we commingle funds collected in both the City and County funds? May we spend money collected from the City's fund on projects in the County, and vice versa?

We have just received the proposed County/City zones and have to study them further before giving you a definitive answer. Preliminarily, we think that funds from the County trust fund and the City trust fund could be combined for use in a single project under circumstances we describe below. We are less certain that the two funds should simply be "commingled" in the sense that they should be collapsed into one for accounting purposes. As to the latter, our concern is with a trustee's general fiduciary duties not to commingle trust funds with other monies, and the requirement in section 66006(b) that the City and the County each provide a yearly accounting for each separate account or fund. Given these requirements, we are reluctant to advise you to collapse the two funds into one.

However, I think that contributions from the City and County trust funds may be combined into a single project which would serve both the City and County workers. To our knowledge,

no state law concerning the governmental powers of cities and counties prohibits either from paying or contributing to a project located extra-territorially. The only issue arises with nexus.

As to nexus, we think the fundamental requirement is that the residents of a given project could reasonably work in buildings which contributed to the account from which the funds for that project were drawn. We do not believe that this is a project-specific determination with a nexus established for each project. This would require that dollars be tagged with the identify of the contributing commercial structure and used in a given residential site to ensure that residents of that site could reasonably commute to the specific donor commercial structure. This would create an accounting nightmare.

Rather, we think that the proposed zonal approach is specific enough. As we understand it, accounting would be done on a zone-by-zone basis, and funds from each zone would be used for projects in that zone, whether collected in the City or County or spent in the City or County. From a nexus standpoint, the argument is that each zone is sufficiently small to ensure that workers could commute from any residence to any commercial donor site in the zone, and thus that within that zone, dollars from individual donor commercial sites could be commingled.

5. Given that the County is not a party to the lawsuit, or subject to it, may we spend the money in the County's fund without setting aside money in another escrow account in the event the City's position is unsuccessful?

As explained above, an ordinance is vulnerable to a facial constitutional challenge during the first year after its enactment. Should such a suit be brought within the statutory period, and should the City's ordinance subsequently be held unconstitutional, the County's ordinance obviously would be vulnerable to invalidation. Therefore, until either the Commercial Builders litigation is decided or the one-year statutory period expires, it would be prudent for the County to set aside monies in the County fund in a separate escrow account.