



DATE: July 18, 2017

TO: Mayor and City Council

FROM: Finance Director

SUBJECT Policy Direction Regarding Community Facilities Districts

RECOMMENDATION

That Council reviews, comments, and provides direction to staff on the formation of Community Facilities Districts and related policy issues.

SUMMARY

This report summarizes the Mello-Roos Community Facilities Act of 1982, the existing processes for the formation of a CFD in Hayward, and recommended options for Hayward in the future.

BACKGROUND

The Mello-Roos Community Facilities Act of 1982

The passage of Proposition 13 in 1978 forced public agencies and real estate developers to look for ways to replace lost property tax revenues and fund the increasing cost of public services and infrastructure. Funding available from traditional assessment districts is limited as well and it became clear that a more flexible funding tool was needed. In response, the California State Legislature (the “Legislature”) approved the Mello-Roos Community Facilities Act of 1982 (the “Act”), which provides agencies the ability to levy a special tax within a defined geographic area if such a levy is approved by two-thirds of the qualified electors within the area and if the agency demonstrates clear benefit(s) to those paying the levy utilizing those funds.

Community facilities districts (CFD) can generate funding for a broad range of services and facilities, and special taxes can be allocated to properties in any reasonable manner other than on an ad valorem basis (a tax based on the value of the property). In addition to funding specified services, a CFD is authorized to issue tax-exempt bonds secured by land within the district. If a parcel owner fails pay the tax assessed to the CFD, an agency can foreclose (similar to the process for delinquent property tax) on the parcel and use the proceeds of the foreclosure sale to make the required principal and interest payments to bondholders. Because bonds issued by a community facilities district are land-secured, there is no risk to a public agency’s general fund or taxing capacity.

City of Hayward Community Facilities Districts

The City has three Community Facilities Districts.

1. Eden Shores (CFD #1) was formed in July 2009 and contains 274 taxed parcels. It is located in the southwestern portion of the City and encompasses a 119-acre site that is part of a larger development known as the Eden Shores Business Park. The tax supports the debt service for an original bonded indebtedness of \$9.965 million to finance various backbone infrastructure and related improvements, including several public street improvements, traffic signals, and various sanitary sewer and storm facilities. Construction of the facilities and public improvements funded through the Bond proceeds is now complete and debt service is paid through the special tax.
2. Cannery Place (CFD #2) was formed in May 2009 and contains 540 taxed parcels. Unlike CFD #1, CFD #2 was formed to levy a special tax to fund public safety services for its residents. No bonded debt was issued. CFD#2 is in the City's former downtown redevelopment area and is part of the Cannery Place project area. In April 2015, the Libitzky and Burbank Residual sites were annexed into the existing Cannery Place Area CFD.
3. City of Hayward Community Facilities District No. 3 (South Hayward BART TOD Project) (CFD #3) was formed in May 2015 and contains 357 taxed units. CFD #3 was formed to levy a special tax to fund public safety and ambulance/paramedic services for its residents. No bonded debt was issued. CFD #3 is located near the South Hayward Bart Station.

As part of the formation process with CFD #1, CFD #2 and pursuant with State Government Code, the City adopted Chapter 8, Article 17 of the Hayward Municipal-Code Local Goals and Policies for Community Facilities Districts (<http://bit.ly/HaywardCFD>). These adopted goals and policies include language providing for a standard condition of approval in all new residential developments regarding CFDs.

Currently, the City requires a \$20,000 deposit in its Conditions of Approval for discretionary planning permits/approvals for residential developers to fund a study/fiscal analysis to determine the need for a CFD and its formation for all developments.

“The developer shall pay the costs of providing public safety services to the project should the project generate the need for additional public safety services. The developer may pay either the net present value of such costs prior to issuance of building permits, or the developer may elect to annex into a special tax district formed by the City and pay such costs in the form of an annual special tax. The developer shall post an initial deposit of \$20,000 with the City prior to submittal of improvement plans to offset the City's cost of analyzing the cost of public safety services to the property and district formation.”

Among other things the study analyzes any deficit between ongoing revenues generated by a project and the added cost of public safety services above existing levels. Resolution 09-049 adopted revisions to the goals and policies to add the specific language in the City's Conditions of Approval (Attachment I).

The State of California's requirements to form a CFD assume that a specific new (or annexed) residential development will add more costs for services than they will generate in new revenues and taxes from the development, thus creating a gap between revenue created and costs expended to serve the development. Current City policy is for all new residential development to mitigate any identified deficit between generated revenue and expenditures necessary to provide expected levels of service; and to ensure that any new development does not negatively impact existing residents, specifically as it relates to public safety services. To accomplish this, the City considers establishing a special tax district for each development requiring discretionary approvals to provide an ongoing funding source for public safety services in future years. To this end, when a new development has been submitted for consideration, the City has collected a \$20,000 deposit from each developer and CFD formation analysis has taken place.

DISCUSSION

Forming CFDs for residential development projects is subject to discretionary planning reviews by the City. These reviews include effort from staff in multiple departments, outside counsel and consultants. Formation also requires agenda items on a minimum of three Council meetings. Currently, it is the City's practice to complete a discretionary planning review and consider CFD formation for all new developments.

As Council is aware from the formation of the City's three current CFDs, there is a tremendous level of effort put forth to form and administer CFDs. By establishing minimum requirements for consideration to form a CFD, it will eliminate this staff effort for developments that do not meet the established requirements and therefore would not substantiate formation. Formation of a CFD for public safety services requires several critical steps that include at least two separate City Council meetings and a timeline of about 60-90 days. Below is a summary of the most critical elements of the process:

1. Update Local Goals and Policies as necessary
2. Complete CFD formation analysis (model)
3. Create and approve a boundary map
4. Adopt a Resolution of Intention to form a CFD
5. Record the boundary map
6. Prepare and file a CFD report
7. Conduct a public hearing on CFD formation – majority protest process
8. If no majority protest, adopt a Resolution of Formation and Resolution Calling Special Election
9. Election (to be held between 90-180 days from adoption of the Resolution of Formation)

A somewhat similar process is conducted for annexation properties. Once a CFD has been formed, the ongoing administration includes the following steps on an ongoing basis. Note that some of the steps below are specific to bond issuance related to CFDs, which would not apply in the case that the City does not issue bonds at the time of formation.

A. Disbursement of Bond Proceeds

Bond proceeds may be held in the City's pooled cash and will be invested as part of the City's pool or held by a third-party trustee. The specific mechanisms for disbursements will be set forth in the bond resolution.

B. Administrative Levies

The City will levy on each property within an assessment district or CFD an annual assessment or special tax, as appropriate, that reflects the costs to the City associated with that district. The maximum rate for each district will be set forth in the Ordinance of Formation. The actual rate of such levy will be based on rates adopted by the Council. These rates will be reviewed from time-to-time to ensure that they accurately reflect City costs.

C. Levy of Special Taxes

The special tax for any CFD will be calculated annually in accordance with the Ordinance of Formation for the subject district and will include any additional levies to meet the coverage requirements for that tax as well as the City's administrative levy. The Director of Finance or designee will be responsible for annually transmitting to Alameda County the information necessary to include the levy on property tax bills. If required or permitted by the Resolution of Formation for that CFD, initial billings of special taxes may be made directly by the City.

D. Administration of and Accounting for Assessment and Special Tax Collections

Prior to September 1 of each year, the Director of Finance or designee will request from the County the delinquency roll for each district and complete the accounting of receipts.

E. Administration of CFD Bonds

After deduction of the administration charges, revenues from the special tax will be deposited in the appropriate debt service funds maintained by the Director of Finance or by a trustee, who will be responsible for paying interest and principal as due. The Director of Finance will be responsible for ensuring other administrative requirements of the bond resolution are met, such as arbitrage and reserve fund administration.

F. Prosecuting Delinquencies

Because CFD bonds are secured exclusively by payments from property owners, bond investors (and letters-of-credit providers for such bonds, if any) will require that the City covenant to prosecute foreclosure on defaulting property within a few months of determining such a default. The City Attorney will be required to file a suit in Superior Court to prosecute such foreclosure. If the special tax or assessment remains unpaid and the foreclosure is prosecuted to conclusion, the property will be sold to the highest bidder at a tax sale, with the proceeds of the sale used to satisfy the delinquent payments.

In CFDs containing more than 100 units, it may not be necessary to foreclose on all delinquent properties as they become delinquent but only when delinquencies reach a pre-determined threshold. Such decisions will be made on a case-by-case basis and governed by the indenture for each bond issuance.

Options for Future CFDs

Option 1: Two Year Moratorium on New CFDs – Recommended

Given the upcoming evaluation and revisions of development codes in the next two years¹, shifts in funding for housing development in Alameda County, and the high costs associated with the formation and ongoing administration of CFDs, staff recommends a moratorium on the formation of new CFDs in Hayward for a two-year period. The Complete Communities strategic initiative outlines extensive work in the next two years around evaluating, creating, and updating development codes, zoning, and fees. Pausing the creation of new CFDs for the next two years would provide staff with the ability to focus on the current tasks included in the initiative, including the assessment of new fees to support City services, and then potentially reassess CFDs in the next iteration of the action plan.

Additionally, the passage of County Measure A1 and subsequent set aside of approximately \$155 million for the creation of affordable housing programs and innovative projects provides a unique opportunity for housing development in Hayward. The high cost and administrative burdens of exploring CFD formation for each development would slow down Hayward's competitiveness in accessing A1 funds.

Option 2: Minimum of 100 units for CFD Formation

If the Council wishes to continue forming CFDs for new development projects, staff recommends establishing a minimum unit count threshold of 100 units. It is not advisable to form CFDs for small, in-fill developments, especially since some of those would not be subject to discretionary review (e.g., Site Plan Review, Zone Change, Tentative Tract Map, etc.). The greatest benefit from a CFD is for a larger development, with a minimum of 100 units.

Option 3: No Change

Continue with the existing policies and procedures for CFDs.

Recent Litigation Involving the Mello-Roos Community Facilities Act of 1982

The City of San Ramon formed a Mello-Roos Community Facilities District comprised of a 48-unit townhome development with a "future annexation area" that was essentially coterminous with the City limits. In March 2014, the Building Industry Association of the Bay Area and the Pacific Legal Foundation sued the City of San Ramon, alleging that the Mello-Roos Community Facilities District special tax for the development was illegal on the grounds that the development was an "infill development" surrounded by developed areas where the services on which the CFD was based (police, streets, and other services) already exist, and

¹ At the [June 20, 2017 City Council meeting](#), Council adopted Resolution No. 17-089, adopting the Council strategic initiatives and the associated two-year action plans for FY 2018 and 2019.

therefore the services would not qualify as “new” and would not meet the requirements necessary to qualify as a CFD under the Mello-Roos Act. The original trial court, and Court of Appeals ruled in favor of the City of San Ramon, in support of the formation of a CFD and the special tax levied on the 48-unit project. The Court held that the requirement for “additional services” was met by services that met the increased demand for existing services within the district because they are “in addition to” the services that had been previously and are continuously provided in the area before the district was created. The Court also concluded that the tax was a special (and not general) tax because it was imposed to fund specified facilities and services, all of which were expressly authorized under the Mello-Roos Act. The California State Supreme Court declined to hear the appeal, thereby ending the two and half years of legal action over the matter.

The City Attorney is prepared to comment on the San Ramon case at the Council meeting.

FISCAL IMPACT

The direct fiscal impact cannot be quantified now because it is unknown how many new developments the City will entitle in any given fiscal year. During fiscal 2016 alone, there have been five developments entitled. All five of these developments would fall below the 100-unit requirement for CFD formation consideration.

PUBLIC CONTACT

At the February 3, 2015 City Council Meeting, former City Manager David presented a report forming Community Facility District #3. This report included discussion of establishing thresholds for CFD formation.

NEXT STEPS

Council’s input and direction is sought regarding the options outlined in this report. If Council recommends changes to the existing policies and procedures for CFDs, staff will integrate Council’s input and direction into a resolution for Council review and approval in September 2017.

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Approved by:



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