

COMMISSION ON STATE MANDATES

1300 I STREET, SUITE 950
SACRAMENTO, CA 95814
(916) 323-3562



October 20, 1998

Ms. Debra J. Bevier, Deputy City Attorney
City of San Diego
1200 Third Ave., Suite 1200
San Diego, CA 92101

Mr. Donald W. Detisch
Detisch & Christensen
444 West C Street, Suite 200
San Diego, CA 92101

And Interested Persons (See mailing list)

RE: Final Staff Analysis, October Commission Hearing
Non Profit, Special Use Property Requirements -CSM 97- TC-01
City of San Diego, Claimant
Code of Civil Procedure Sections 1235.155, 1263.320 and 1263.321
Evidence Code Sections 823 and 824
Government Code Section 7267.9
Chapter 7, Statutes of 1992

The final staff analysis of the test claim entitled CSM-97-TC-01 *Non Profit, Special Use Property Requirements* has been completed and is enclosed. The hearing on the test claim is set for October 29, 1998.

Hearing

This test claim is set for hearing on October 29, 1998, at 9:30 a.m. in Room 437 of the State Capitol, Sacramento, California.

Please be advised that the Commission Chair is authorized to limit oral testimony to a time prescribed by the Chair in order to facilitate the agenda. (§ 1187.6, subd. (c) of the Commission's regulations.) Generally, the Commission has limited testimony to 15 minutes per party and 5 minutes for interested parties.

Ms. Debra J. Bevier
Mr. Donald W. Detisch
October 20, 1998
Page 2

In addition, for hearings on test claims, witnesses are sworn in en masse at the commencement of the hearing. (§ 1187.5, subd. (b) of the Commission's regulations.)

Should you have any questions, please contact Camille Shelton, Staff Counsel, at (916) 323-3562.

Sincerely,



PAULA HIGASHI
Executive Director

c: Mailing List

Enc. Final staff analysis

Hearing Date: October 29, 1998
File Number: CSM-97-TC-01

ITEM # 2
Staff Analysis

Code of Civil Procedure Sections 1235.155, 1263.320 and 1263.321
Evidence Code Sections 823 and 824
Government Code Section 7267.9
As added or amended by Chapter 7, Statutes of 1992

Nonprofit, Special Use Property Requirements

Table of Contents

Staff Analysis	0003
Exhibit A	
City of San Diego Test Claim	0021
Exhibit B	
Opposition from the Department of Finance.....	0045
Exhibit C	
Memorandum in Support of the City of San Diego's Test Claim,.....	0051
St. Mark's Episcopal Church	
Exhibit D	
City of San Diego's Rebuttal	0057
Exhibit E	
Draft Staff Analysis.....	0063
Exhibit F	
Response by the City of San Diego to Draft Staff Analysis	0075
Exhibit G	
Response by St. Mark's Episcopal Church to Draft Staff Analysis.....	0089
Exhibit H	
<i>City of Merced v. State of California</i> (1984) 153 Cal. App. 3d 777.....	0135

Exhibit I	
<i>County of Contra Costa v. State of California</i> (1986) 177 Cal.App.3d 62	0141
Exhibit J	
<i>United States v. Toronto, Hamilton & Buffalo Navigation Co.</i> (1949) 338 U.S. 396	0153
Exhibit K	
<i>United States v. 100 Acres of Land</i> (1972) 468 F.2d 1261	0161
Exhibit L	
<i>Redevelopment Agency v. First Christian Church</i> (1983) 140 Cal.App.3d 690	0171
Exhibit M	
<i>United States v. 50 Acres of Land</i> (1984) 469 U.S. 24	0183
Exhibit N	
<i>United States v. 564.54 Acres of Land in Monroe and Pike Counties</i> (1979) 441 U.S. 506, 99 S.Ct. 1854	0191
Exhibit O	
<i>State of Washington v. United States</i> (1954) 214 F.2d 33	0199
Exhibit P	
<i>State of California v. United States</i> (1968) 395 F.2d 261	0213
Exhibit Q	
<i>United States v. Los Angeles County</i> (1947) 163 F.2d 124	0221
Exhibit R	
<i>United States v. Board of Education</i> (1958) 253 F.2d 760	0223
Exhibit S	
<i>Marin Hospital District v. Rothman</i> (1983) 139 Cal.App.3d 495	0229
Exhibit T	
<i>The Union League Club v. Johnson</i> (1941) 18 Cal.2d 275	0235
Exhibit U	
<i>Clements v. T.R. Bechtel Company</i> (1954) 43 Cal.2d 227	0239
Exhibit V	
Report by the Senate Committee on Judiciary for SB 821	0249

Hearing Date: October 29, 1998
File Number: CSM-97-TC-01
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ITEM # 2

Staff Analysis

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Evidence Code Sections 823 and 824
Government Code Section 7267.9
As added or amended by Statutes of 1992, Chapter 7

Nonprofit, Special Use Property Requirements

EXECUTIVE SUMMARY

Introduction

Eminent domain is the power of government to take private property for public use. California's eminent domain law is contained in the Code of Civil Procedure beginning with section 1230.010. The law does not require that the power of eminent domain be exercised, rather this power is left to the discretion of the governmental entity authorized to acquire the property.

The Fifth Amendment to the federal Constitution mandates that private property must not be taken for public use without "just compensation." The general measure of just compensation is "fair market value" (i.e., the highest price that would be agreed to by a seller willing to sell, and a buyer who is ready, willing and able to buy, each dealing with the other under circumstances totally free from external pressures).

However, the U.S. Supreme court recognized that fair market value, as the measure of just compensation is not an absolute standard nor an exclusive method of valuation. An exception arises when the fair market value is not ascertainable. Such cases, for the most part, involve properties that are seldom, if ever, sold in the open market. Thus, under the constitutional requirement of just compensation, basic equitable principles of fairness dictate that other valuation methods be employed to determine an appropriate condemnation sum.

Test Claim Legislation

The test claim legislation affected several statutory provisions (specified in the caption above) pertaining to the payment of just compensation when property is taken by eminent domain and the property has no relevant, comparable value. Property with no relevant, comparable value is defined as "nonprofit, special use property" such as a school, church, cemetery, or hospital. If a governmental entity elects to condemn property that is characterized as nonprofit, special use property, the calculation of just compensation shall be based on the value of reproducing the improvements located on the land without taking into consideration any depreciation or obsolescence of the improvements.

In addition, the test claim legislation requires public entities, prior to commencing action to acquire nonprofit, special use property through eminent domain, to make every reasonable effort to seek alternative property for the project, except as specified.

Claimant's Position

The claimant, City of San Diego, contends that not all eminent domain actions are discretionary. After the local agency has made a specific finding that the condemnation is necessary, taking the particular property by eminent domain is also necessary. A local agency would be remiss if it ignored its responsibility to redevelop and improve roadways and other projects that only condemnation is able to provide.

The claimant also contends that the court decision of *City of Merced* does not apply. The court in *City of Merced* held that the power of eminent domain is optional. The claimant contends that *City of Merced* ruled on the reimbursement of additional costs corresponding to the payment of lost goodwill owed to a business owner whose property was taken by eminent domain. This test claim alleges additional costs when a local agency uses the power of eminent domain to condemn nonprofit, special use property.

Further, the claimant contends that the test claim legislation spells out a new specific manner that must be used to appraise nonprofit, special use property. This new statutory appraisal method does not permit the deduction of depreciation or obsolescence of such property and, thereby, causes increased costs. Thus, the claimant asserts that under prior law, it would have been permissible to offset the appraisal sum by an amount equal to the depreciation of the condemned property.

Finally, the claimant contends that the requirement to seek alternative property before acquiring nonprofit, special use property constitutes a higher level of service.

St. Mark's Episcopal Church's Position

St. Mark's Episcopal Church agrees with the claimant. The test claim legislation represents a reimbursable state mandated program because the amount of depreciation or obsolescence is no longer permitted as an offset under the statutory valuation method for nonprofit, special use property. Furthermore, local agencies are now required to perform a higher level of service by seeking alternative property before acquiring nonprofit, special use property.

St Mark's further contends that the court decision of *City of Merced* does not apply since the court relied, in part, on the former reimbursement scheme under the Revenue and Taxation Code. St. Mark's also argues that the court's analysis in *City of Merced* is flawed.

Department of Finance's Position

The Department of Finance contends that *City of Merced* does apply to this test claim. That decision held that eminent domain proceedings are optional and any costs incurred by local government resulting from such proceedings are not state mandated.

Staff Analysis and Recommendation

Staff finds that the test claim legislation does not constitute a reimbursable state mandated program upon local agencies under section 6, article XIII B because:

- the exercise of the power of eminent domain is discretionary and not state mandated,
- once a local agency elects to acquire property that contains nonprofit, special use property, the downstream activities, including the statutory requirement to seek alternative property before negotiating with the owner and the payment of just compensation for the property taken, are *not* state mandated,
- evidence of additional costs alone without a corresponding increase in the level of service performed by a local agency does not result in reimbursement, and
- payment of just compensation under eminent domain is mandated by the U.S. Constitution.

Therefore, staff recommends that the Commission deny this test claim.

Claimant

City of San Diego

Chronology

- 8/27/97 Test claim filed by City of San Diego.
- 10/1/97 Response filed by Department of Finance.
- 10/28/97 Claimant submits rebuttal.
- 10/30/97 Memorandum in support of test claim filed by St. Mark's Episcopal Church.
- 10/30/97 Commission hearing, finding of disputed test claim made.
- 5/08/98 Draft Staff Analysis issued.
- 5/26/98 St. Mark's Episcopal Church requests extension to file comments and postponement of Commission hearing.
- 7/21/98 Claimant requests extension to file comments and postponement of Commission hearing.
- 10/6/98 Claimant files response to Draft Staff Analysis.
- 10/7/98 St. Mark's Episcopal Church files response to Draft Staff Analysis.

Introduction

The test claim legislation affected several statutory provisions pertaining to the payment of just compensation when property is taken by eminent domain and the property has no relevant, comparable value. Property with no relevant, comparable value is defined as "nonprofit, special use property" such as a school, church, cemetery, or hospital.¹ If a governmental entity elects to condemn property that is characterized as nonprofit, special use property, the calculation of just compensation shall be based on the value of reproducing the improvements located on the land without taking into consideration any depreciation or obsolescence of the improvements. The test claim legislation also requires local agencies to seek alternative property before acquiring nonprofit, special use property.

In the present case, the claimant condemned church property located in an area that had one of the highest crime rates in the City of San Diego for purposes of redevelopment. The church was located in the center of the multi-block area and was needed by the City for use in the construction of the proposed police station.²

¹ The test claim legislation defines nonprofit, special use property as "property which is operated for a special, nonprofit, tax-exempt use such as a school, church, cemetery, hospital, or other similar property." It does not include property owned by a public entity. (Code Civ. Proc., § 1235.155.)

² Declaration of Michael R. Steffen, Deputy Director of the Real Estate Assets Department of the City of San Diego, Bates page 0083.

Staff Analysis

Issue: Does the test claim legislation, which determines the valuation of nonprofit, special use property taken by eminent domain, impose a reimbursable state mandated program upon local agencies under article XIII B, section 6 of the California Constitution and section 17514 of the Government Code?

The main statute at issue is Evidence Code section 824, which provides in relevant part:

“(b) Notwithstanding any other provision of this article, a witness providing opinion testimony on the value of nonprofit, special use property, as defined by Section 1235.155 of the Code of Civil Procedure, for which there is no relevant, comparable market, shall base his or her opinion on the value of reproducing the improvements *without taking into consideration any depreciation or obsolescence of the improvements. . . .*”

In addition, the test claim legislation requires local agencies, prior to commencing action to acquire nonprofit, special use property through eminent domain, to make every reasonable effort to seek alternative property for the project, except as specified. (Gov. Code, § 7267.9.)³

In order for a statute to impose a reimbursable state mandated program, the statutory language must first direct or obligate an activity or task upon local governmental entities. If the statutory language does not direct or obligate local agencies to perform a task, then compliance with the test claim statute is within the discretion of the local entity and a reimbursable state mandated program does not exist. In addition, the required activity or task must be new or create an increased or higher level of service over the former required level of service. To determine if a required activity is new or imposes a higher level of service, a comparison must be undertaken between the test claim legislation and the legal requirements in effect immediately prior to the enactment of the test claim legislation. Finally, the newly required activity or increased level of service must be state mandated.⁴

³ The test claim legislation also amended Code of Civil Procedure section 1263.320, subdivision (b), and Evidence Code section 823 by adding the word “comparable.” No other substantive changes were made. Code of Civil Procedure section 1263.320, subdivision (b), now provides the following:

“(b) The fair market value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable.”

Evidence Code section 823 now provides the following:

“Notwithstanding any other provision of this article, the value of property for which there is no relevant, comparable market may be determined by any method of valuation that is just and equitable.”

⁴ *County of Los Angeles v. State of California* (1987) 43 Cal.3d 46, 56; *Carmel Valley Fire Protection Dist. v. State of California* (1987) 190 Cal.App.3d 521, 537; *City of Sacramento v. State of California* (1990) 50 Cal.3d 51, 66; *Lucia Mar Unified School Dist. v. Honig* (1988) 44 Cal.3d 830, 835.

The Exercise of the Power of Eminent Domain is Discretionary.

California's eminent domain law, as provided in Code of Civil Procedure section 1230.030, states that:

“Nothing in this title requires that the power of eminent domain be exercised to acquire property necessary for public use. Whether property necessary for public use is to be acquired by purchase or other means or by eminent domain is a decision left to the discretion of the person authorized to acquire the property.” (Emphasis added.)

Despite the express statutory provisions of California law, the claimant argues that the exercise of eminent domain is “not necessarily a discretionary act” and thus, reimbursement is required under article XIII B, section 6. The claimant contends that:

- while there is some discretion involved in a local agency's decision, that discretion should not prevent a local agency from receiving proper reimbursement for state mandates,
- even if the Commission determines that all condemnation actions are discretionary and not mandated for the public good, the local agency's costs are multiplied, not because of the local agency's decision to condemn, but as a direct result of the test claim legislation, and
- the need to exercise a condemnation action is no different than local law enforcement agencies using their discretion to make an arrest and prosecute. The claimant cites two prior test claims approved by the Commission, namely *Search Warrant: Aids and Misdemeanors: Booking and Fingerprinting*, to support its contention that the Commission previously approved acts for reimbursement that were contingent upon the discretionary act of making an arrest.⁵

St. Mark's Episcopal Church (hereafter, St. Mark's) also contends that eminent domain is not always discretionary. St. Mark's states that “eminent domain is the sole means by which the government can operate its property acquisition program where a land owner refuses to ‘grant,’ ‘lease,’ ‘gift,’ ‘devise,’ or ‘contract’ for the transfer of his property to the agency.” St. Mark's further contends that the practical and legal constraints tied to eminent domain severely limit any discretion a local agency may enjoy. St. Mark's also states that the “use of the phrase

⁵ The test claim in *Misdemeanors: Booking and Fingerprinting* (CSM - 4436) addressed Penal Code section 853.6 which required law enforcement agencies to provide a person arrested for a misdemeanor with verification of the booking or fingerprinting. The test claim in *Search Warrant: Aids* (CSM - 4392) addressed Penal Code section 1524.1 which required the district attorney to notify crime victims of their right to request a search warrant to test a person charged with a crime for HIV. In both cases, the Commission found a reimbursable state mandated program.

Although the claimant urges the Commission to consider these prior final decisions as precedent, staff notes that test claims previously approved by the Commission have no precedential value. (See, 72 Ops. Cal. Atty. Gen. 173, 178, fn.2 (1989), which states: “It is long settled that due process permits substantial deviation by administrative agencies from the principles of stare decisis. [Citation omitted.] An agency may disregard its earlier decision, provided that its action is neither arbitrary or unreasonable. [Citation omitted.]”)

'discretion' in section 1230.030 simply clarifies the fact that eminent domain is not the exclusive means by which the government is permitted to acquire private property."⁶

However, based upon the plain and ordinary meaning of the words used by the Legislature in section 1230.030, staff submits the statutory provisions clearly spell out that the exercise of eminent domain is a discretionary act and not mandated by the state.⁷

In addition to the plain reading of the statutory provisions governing eminent domain, court decisions have ruled that eminent domain is discretionary. Similar to the test claim legislation, the *City of Merced* case⁸ involved increased costs incurred by a local agency resulting from the exercise of eminent domain. At issue in *City of Merced* was Code of Civil Procedure section 1263.510, a statute enacted in 1975 that required the compensation for the loss of goodwill in eminent domain proceedings.

City of Merced analyzed California's eminent domain law and found that the power of eminent domain is not state mandated and, thus, the payment for the loss of goodwill is likewise not state mandated. The court stated:

" . . . the Legislature made clear the discretionary nature of acquisition of property by eminent domain by passage of Code of Civil Procedure section 1230.030. Section 1230.030 was included within Chapter 1275, Statutes of 1975, the same legislation that changed the law of eminent domain to require compensation for business goodwill. . . ."

"We agree that the Legislature intended the payment of goodwill to be discretionary. . . . [W]hether a city or county decides to exercise eminent domain is, essentially, *an option* of the city or county, rather than a mandate of the state. The fundamental concept is that the city or county is *not required* to exercise eminent domain. If, however, the power of eminent domain is exercised, then the city will be required to pay for loss of goodwill. Thus, payment for loss of goodwill is *not a state-mandated cost*." (Emphasis added.)⁹

A subsequent court decision, *County of Contra Costa*, affirmed the ruling in *City of Merced* by stating:

" . . . the decision to proceed in eminent domain is *optional* with the local government. Since the *state does not mandate* that the local agency

⁶ Exhibit G, Response to Draft Staff Analysis, Bates pages 0089.

⁷ Where the meaning of a statute is plain, its language is clear and unambiguous, and there is no uncertainty or doubt of legislative intent, there is *no* need for statutory construction. (See, Exhibit H, *City of Merced v. State of California* (1984) 153 Cal.App.3d 777, 780; Exhibit S, *Marin Hospital Dist. v. Rothman* (1983) 139 Cal.App.3d 495, 498-499; and *County of Los Angeles, supra*, 43 Cal.3d at 55.)

⁸ Exhibit H, *City of Merced v. State of California, supra*, 153 Cal.App.3d 777.

⁹ *Id.* at 783.

incur the costs it claims, the agency is not entitled to reimbursement from the state. (Emphasis added.)¹⁰

Both the claimant and St. Mark's argue that *City of Merced* does not apply in this case. The claimant states the following:

"*City of Merced* dealt with a very specific area of eminent domain law regarding the payments for loss of goodwill and the facts and circumstances of that case do not apply to all eminent domain actions. An important difference between *City of Merced* and the test claim legislation is what *City of Merced* did not do. *City of Merced* did not mandate the manner in which the loss of goodwill was to be calculated, and it did not mandate that the value of the affected businesses could not be lowered based on obsolescence or depreciation."¹¹

St. Mark's states the following:

"...the *Merced* case is flawed. First, *Merced* relies on the same incorrect interpretation of Code of Civil Procedure section 1230.030 that staff is propounding. That statute simply does not support the sweeping proposition that all exercise of the power of eminent domain is 'discretionary.' Second, *Merced* relied on budget control language to demonstrate 'legislative intent.' Thus, the discussion by the Court of discretionary versus mandatory is not relevant. The legislature had spoken and the Court was merely following its pronouncement.

"Finally, *Merced* relies in part on a statute that has now been repealed. The statute at issue, Revenue and Taxation Code section 2207, was repealed in 1989 based on 'obsolescence.' Thus, the repeal of this section further erodes the precedential value of the decision. If anything, the repeal of this statute instead strengthens the City of San Diego's claim. Since Revenue and Taxation Code section 2207 was repealed for 'obsolescence,' it stands to reason that the legislature believed that its provisions were subsumed within other provisions of the present statutory reimbursement framework. Since the present case would have been reimbursable under the express law existing at the time of the *City of Merced* decision, this case only stands for the proposition that the City of San Diego's claim should be approved."¹²

Staff disagrees with the above contentions. Although the issue in *City of Merced* was the payment of goodwill, the court looked at the law of eminent domain, including section 1230.030, which describes the power of eminent domain as discretionary, to support its conclusion.

¹⁰ Exhibit I, *County of Contra Costa v. State of California* (1986) 177 Cal.App.3d 62, 79-80.

¹¹ Exhibit F, Response to Draft Staff Analysis, Bates page 0075.

¹² Exhibit G, Response to Draft Staff Analysis from St. Mark's Episcopal Church, Bates page 0089.

St. Mark's correctly notes that the State in the *City of Merced* case supported its argument to deny reimbursement for the payment of loss of goodwill in eminent domain cases, *in part*, on budget control language, which rejected payment of such claims. However, the State also contended that the "*more significant*" reason to deny reimbursement was the plain and ordinary language of section 1230.030, which describes the power of eminent domain as discretionary. The court recognized section 1230.030 and relied on *both* the plain and ordinary language in section 1230.030 and the Legislature's pronouncement in the budget, when it concluded that eminent domain was optional and not mandated by the State.

Further, St. Mark's reliance on *former* Revenue and Taxation Code section 2207 to support its contention that reimbursement is required under section 6 is misplaced. Former section 2207, defining "costs mandated by the state", was enacted as part of Senate Bill 90 and became effective on July 1, 1981, one year *after* the City of Merced incurred costs for the payment of goodwill through its eminent domain action. Subdivision (h) of former section 2207 extended state liability by requiring reimbursement for increased costs incurred by a local agency due to a statute that added new requirements to an existing *optional* program, if the local agency had no reasonable alternative other than to continue the optional program.

The court in *City of Merced* noted that local agencies, including the City of Merced, would not receive the benefit of section 2207 until it became effective in 1981. The court stated that "until [SB 90] was enacted, increased costs incurred in an *optional program such as eminent domain* were not state-mandated."

Former Revenue and Taxation Code section 2207 was expressly repealed by the Legislature in 1989.¹³ There is no evidence to support St. Mark's proposition that the provisions of former section 2207 "were subsumed within other provisions of the present statutory reimbursement framework." Rather, when the Legislature expressly repeals an existing statute and enacts a new statute on the same subject that contains a material change, it is presumed that the Legislature intended to change the law.¹⁴

Today, Government Code section 17514 defines "costs mandated by the state" as any increased costs which a local agency is required to incur as a result of a statute that mandates a new program or higher level of service within the meaning of article XIII B, section 6 of the California Constitution.¹⁵ Under Government Code section 17514, reimbursement is *not* required for increased costs incurred in an optional program.

¹³ Stats. 1989, c. 589.

¹⁴ Exhibit T, *Union League Club v. Johnson* (1941) 18 Cal.2d 275; Exhibit U, *Clements v. T.R. Bechtel Co.* (1954) 43 Cal.2d 227.

¹⁵ Government Code section 17514 was enacted by the Legislature in 1984. (Stats. 1984, c. 1459.) From 1984 until former Revenue and Taxation Code section 2207 was repealed in 1989, both statutes, which defined "costs mandated by the state" differently, were in effect. However, when the Legislature enacted Government Code section 17514, it also enacted Government Code section 17552, which, at that time, provided the following guidance to the Commission:

"This chapter shall provide the sole and exclusive procedure by which a local agency or school district may claim reimbursement for costs mandated by the state as required by section 6 of Article XIII B of the California Constitution *or* for costs mandated by the

In addition, Government Code section 17552 provides that “[t]his chapter [beginning with Government Code section 17500] shall provide the sole and exclusive procedure by which a local agency or school district may claim reimbursement for costs mandated by the state as required by Section 6 of Article XIII B of the California Constitution.” Section 17552 does not include any references to the former reimbursement scheme under the Revenue and Taxation Code.

Thus, if the Legislature intended to require state reimbursement for increased costs in optional programs, it would have kept the language of Revenue and Taxation Code 2207, subdivision (h).

Furthermore, staff submits that the repeal of section 2207 does not erode the precedential effect of the *City of Merced* case. As noted above, the court in *City of Merced* also relied on Code of Civil Procedure section 1230.030, which defines eminent domain as discretionary. That section still exists.

Additionally, the court’s recognition in *City of Merced* that the claimant was not entitled to state reimbursement for increased costs incurred in an optional program such as eminent domain still applies. The City of Merced experienced increased costs at a time when the statutory scheme did not require reimbursement for optional programs. Similarly, the present statutory scheme does not require reimbursement for optional programs.

Therefore, staff finds that Code of Civil Procedure section 1230.030 and the court’s decision in *City of Merced* are relevant to this test claim and support the conclusion that acquiring nonprofit, special use property through eminent domain is optional and not mandated by the state.

Moreover, recent court decisions explain that when a local agency performs a permissive act, or has alternatives other than performing the action under the test claim statute, the “downstream” or consequential activities, although statutorily required, are *not* state mandated. For example, in *Lucia Mar*, the California Supreme Court found that a newly enacted ten percent payment by a school district was a “new program” when the district sent its disabled pupils to a state school for the severely handicapped. While the ten percent payment was required by the Education Code, the court, however, did *not* find that sum was state mandated and, therefore, reimbursable. The court recognized that school districts may have several options for furnishing special education to its disabled pupils, only one of which is sending them to a state school. Thus, the court remanded to the Commission the question of whether the ten percent payment was state mandated.¹⁶

state, as defined in Section 2207 or 2207.5 of the Revenue and Taxation Code, pursuant to a statute enacted, or an executive order implementing a statute enacted, *before* January 1, 1975.”

In 1986, the legislature amended Government Code section 17552 (Stats. 1986, c. 1459) by deleting all references to Revenue and Taxation Code section 2207 and 2207.5.

¹⁶ *Lucia Mar Unified School Dist. v. Honig, supra*, 44 Cal.3d at 836-837; *County of Los Angeles v. Commission on State Mandates* (1995) 32 Cal.App.4th 805, 818.

Similarly, local agencies have several options in acquiring property that contains nonprofit, special use property, only one of which is taking the property by eminent domain. Although the City of San Diego in the present case felt that it was necessary to redevelop the area in question, it had the option of allowing the church to remain and build the proposed police station in another location within the area. Thus, once the City of San Diego, or any other local agency elects to acquire property that contains nonprofit, special use property, the downstream activities, including the statutory requirement to seek alternative property before negotiating with the owner and the payment of just compensation for the property taken, are *not* state mandated.

Based on the foregoing authorities, staff finds that the taking of nonprofit, special use property through eminent domain is optional, and not state mandated. Therefore, the additional costs incurred by a local agency resulting from the non-deductibility of depreciation for nonprofit, special use property, and the investigation into alternative property, are likewise not state mandated.

Evidence of Additional Costs Alone Without a Corresponding Increase in the Level of Service Performed by Local Agency Does Not Result in Reimbursement.

The claimant’s primary contention is that statutes in question cause local agencies to incur increased costs because a depreciation deduction is disallowed when appraising nonprofit, special use property. However, the California Supreme Court ruled that evidence of additional costs alone does not automatically equate to a reimbursable state mandated program under section 6, article XIII B.¹⁷ Rather, it is paramount that the additional costs result from new programs or increased levels of service mandated by the state.

In the situation at hand, the power to exercise eminent domain is a long-standing discretionary governmental right. The test claim legislation did not mandate any higher level of service upon local agencies. Although the claimant can show additional costs corresponding to the non-deductibility of depreciation and the requirement to seek alternative property, there is no new service or activity that must be provided by the local agency upon the exercise of eminent domain.

Payment of “Just Compensation” in Eminent Domain is Mandated by the U.S. Constitution.

Staff further submits that the appraisal method specified in the test claim legislation is federally mandated by the U.S. Constitution.¹⁸ The 5th Amendment to the federal Constitution mandates

¹⁷ *County of Los Angeles v. State of California, supra*, 43 Cal.3d 46, 56.

¹⁸ Government Code section 17556 provides in pertinent part the following:

“The commission shall *not* find costs mandated by the state, as defined by Section 17514....if the commission finds that:

“.....”

“(b) The statute or executive order affirmed for the state that which had been declared existing law or regulation by action of the courts.”

that private property must not be taken for public use without “just compensation.” The general measure of just compensation is “fair market value”: i.e., the highest price that would be agreed to by a seller willing to sell, and a buyer who is ready, willing and able to buy, each dealing with the other under circumstances totally free from external pressures.¹⁹

However, the U.S. Supreme Court recognized that fair market value, as the measure of just compensation is not an absolute standard or an exclusive method of valuation. An exception arises when the fair market value is not ascertainable. Such cases, for the most part, involve properties that are seldom, if ever, sold in the open market.²⁰ When a type of property is so infrequently traded, it is difficult to predict whether the prices previously paid would be repeated in a sale of the condemned property.²¹ Thus, under the constitutional requirement of just compensation, basic equitable principles of fairness dictate that other valuation methods be employed to determine an appropriate condemnation sum.

When addressing condemned properties that are seldom traded on the open commercial market and are operated for nonprofit, the federal courts apply the “substitute facilities” doctrine or formula to insure that sufficient payment is owed to the condemnee to finance a replacement of the condemned facility.²²

In *United States v. Board of Education*,²³ the federal court applied the “substitute facilities” doctrine to school premises taken by eminent domain in connection with a flood control project. Although the court noted that the school premises had no market value, the court stated that:

“[a]ny reasonable [person] would say that where the government takes a part of the property necessary to the proper operation of a school, the

“(c) The statute or executive order implemented a federal law or regulation and resulted in costs mandated by the federal government, unless the statute or executive order mandates costs which exceed the mandate in that federal law or regulation.”

¹⁹ California has codified these principles in Code Civil Procedure sections 1263.310 and 1263.320, subdivision (a). Historically, the courts have appraised fair market value in one of three ways: (1) the market data approach which values property by comparing recent sales of comparable properties (2) the income approach which recognizes the reasonable rental value of the land and its existing improvements and (3) the reproduction or replacement approach which takes into account the value of the land plus the cost of replacing or reproducing existing improvements, less depreciation or obsolescence of the improvements. (Exhibit J, *United States v. Toronto, Hamilton and Buffalo Nav. Co.* (1949) 338 U.S. 396, 402-403; Exhibit K, *United States v. 100 Acres of Land in Marin County* (9th Cir. 1972) 468 F.2d 1261, 1265; and Exhibit L, *Redevelopment Agency v. First Christian Church* (1983) 140 Cal.App.3d 690, 705. In 1965, California codified these three approaches in Evidence Code sections 816, 819, and 820.)

²⁰ Exhibit M, *United States v. 50 Acres of Land* (1984) 469 U.S. 24, 30.

²¹ Exhibit N, *United States v. 564.54 Acres of Land in Monroe and Pike Counties, Pennsylvania* (1979) 441 U.S. 506, 513.

²² Exhibit O, *State of Washington v. United States* (9th Cir. 1954) 214 F.2d 33; Exhibit P, *State of California v. United States* (9th Cir. 1968) 395 F.2d 261; Exhibit Q, *United States v. Los Angeles County* (9th Cir. 1947) 163 F.2d 124.

²³ (4th Cir. 1958) 253 F.2d 760 (Exhibit R).

government should make it possible for the school to acquire other property to use in *substitution* for the property taken.²⁴

The court went on to reference a passage from a U.S. Supreme Court decision where a town's property was taken for reservoir purposes: "If three-quarters of it is to be destroyed by [eminent domain] both those ousted and those in the remaining quarter, as well as the state . . . are injured. A method of compensation by *substitution* would seem to be the best means of making the parties whole."²⁵

Moreover, *United States v. Board of Education* says that:

" . . . we are not here dealing with a rigid, blind measure, that grants compensation only on a pound of flesh basis, but rather with an equitable concept of justice and fairness that accords with the *Fifth Amendment's mandate*. Accordingly, the equivalence requirement which must be met with respect to the *substitute facility* is more that of utility than of mere dollar and cents value. [Citations omitted.]^{26,27} (Emphasis added.)

In the instant matter, the test claim legislation resembles the federal "substitute facilities" doctrine. Under new Evidence Code section 824, a just and equitable method of determining the value of nonprofit, special use property, for which there is no relevant, comparable market, is the cost of purchasing land and the reasonable cost of making it suitable *for the conduct of the same* nonprofit, special use, together with the cost of *constructing similar* improvements. The value of reproducing the substitute facility will not take into consideration any depreciation or obsolescence of the condemned property.

²⁴ *Id.* at 763.

²⁵ *Id.*

²⁶ *Id.* at 764.

²⁷ In the claimant's response to the Draft Staff Analysis, the claimant discusses a number of cases cited by staff to contend that the Staff Analysis misleads the Commission. The claimant states that the staff analysis leads the reader to believe that the "substitute facilities" doctrine was used in all cases. That is not the case. As described in the body of the analysis, the only cases which used the "substitute facilities" doctrine was *United States v. Board of Education* and the three cases cited in footnote 22.

Moreover, the cases referenced by the claimant were not cited by staff in support of the "substitute facilities" doctrine. Rather, *United States v. Toronto, Hamilton & Buffalo Navigation Co.* (see fn. 19) is cited for the court's description of the historical approach used by the courts in appraising the fair market value of property.

United States v. 50 Acres of Land (see fn. 20) is cited for the court's recognition that fair market value as a measure of just compensation is not an absolute or exclusive method. In addition, the court in that case did not use the substitute facilities doctrine because the court determined that there *was* a market for the property taken. Here, the test claim legislation deals with nonprofit, special use property—property for which there is *no* relevant, comparable market.

United States v. 564.54 Acres of Land (see fn. 21) is cited for the court's recognition that property infrequently traded is difficult to value. The court analyzed the substitute facilities doctrine, but did not apply it based on its finding that there *was* a market for the property taken.

Staff submits that the exclusion of depreciation or obsolescence from the eminent domain valuation is designed to avoid short changing the condemned owner from establishing the same facility in a new location.

Of particular significance is the court decision in *First Christian Church*, which analyzed the taking of church property. The local agency offered \$1.5 million, but the church demanded over \$3 million. The major issue in the case was the value of the church building itself. By introducing evidence of other sales of church property, the local agency attempted to prove that the church building had no value. The appellate court affirmed the trial court's ruling to reject the introduction of evidence that the price offered was comparable to other sales and agreed with the replacement and reproduction approach under Evidence Code section 820. Even though section 820 takes permits the deduction of depreciation, the appellate court cautioned that public agencies should not use depreciation or obsolescence as a "back door" method to nullify the value of the church.

"It is apparent that . . . [under the appraisal methods], depreciation and obsolescence become the major focal point of controversy. We hasten to point out, however, that in our view depreciation and obsolescence should *not* be used as a 'back door' method of nullifying the reproduction and replacement approach to valuation. For example, a large ornate church, as here, because it is used by only a small congregation might be viewed by some as obsolete and having no value beyond that of the land itself. The church, however, does have value to the congregation and the congregation is entitled to compensation therefor. A property owner should not be penalized by application of a concept of locational or functional obsolescence simply because it happens to be in the wrong place at the wrong time when a condemning agency decides to make its move." (Emphasis added.)²⁸

In response to the foregoing analysis, both the claimant and St. Mark's contend that the test claim legislation goes beyond the requirement imposed by the federal Constitution to pay "just compensation" and is thus state mandated. Staff disagrees.

As indicated above, the "just compensation" clause of the U. S. Constitution is based on principles of justice and fairness. Evidence Code section 823, which was amended by the test claim legislation, expressly recognizes these constitutional principles and provides that "the value of property for which there is no relevant, comparable market may be determined by any method of valuation that is *just* and *equitable*."

Furthermore, the U.S. Supreme Court has described the guiding purpose of the "just compensation" clause as follows:

"The guiding principle of just compensation is reimbursement to the owner for the property interest taken. He is entitled to be put in as good

²⁸ *Redevelopment Agency v. First Christian Church*, *supra*, 140 Cal.App.3d at p. 698.

a position pecuniarily as if his property had not been taken. He must be made *whole* but is not entitled to more.”²⁹

In the present case, legislative history of the test claim legislation indicates that the purpose of deleting evidence of depreciation or obsolescence of the improvements on the property is to make owners of nonprofit, special use property whole by allowing them to rebuild elsewhere.

“....”the [replacement and reproduction approach] appeared to work in *First Christian* because the court identified the property as property without a relevant market for comparison purposes and instructed the jury as to alternative forms of valuation. The result was a jury award that approximated 84% of the defendant’s demand. Why it does not work, assert the proponents, is that the law fails to adequately compensate the owner of special use property. *Even under the cost-analysis (or reproduction costs less depreciation) formula used in First Christian, the compensation is said to be inadequate because it does not enable the owner to rebuild elsewhere. States the sponsor: “You cannot build ‘old’”.*³⁰

Thus, the test claim legislation attempts to prevent the deduction for depreciation or obsolescence as a technique of nullifying the just value of the nonprofit, special use property and, at the same time, allows owners to rebuild substitute facilities.

Accordingly, staff finds that additional costs corresponding to the non-deductibility of depreciation or obsolescence under the test claim legislation falls within the 5th Amendment’s mandate of awarding just compensation to owners of nonprofit, special use property fashioned by the federal courts, and is not state mandated.^{31, 32}

²⁹ Exhibit P, *State of California v. United States*, *supra*, 395 F.2d at 265, quoting from the U.S. Supreme Court’s decision in *United States v. Virginia Electric & Power Co.* (1961) 365 U.S. 624.

³⁰ Exhibit V, Report by the Senate Committee on Judiciary for SB 821, dated April 23, 1991.

³¹ Also, the Commission is prevented by the California Constitution from declaring the appraisal formula under the test claim legislation unconstitutional. Article 3, section 3.5, of the state Constitution provides that “an administrative agency . . . has no power to declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional.” Therefore, until an appellate court rules that the test claim legislation is wrong or unconstitutional, the Commission is required to deem the test claim formula correct and in compliance with the “just compensation” clause of the federal Constitution.

³² For the reasons stated above, St. Mark’s reliance on *Long Beach Unified School District v. State of California* (1990) 225 Cal.App.3d 155 is misplaced. *Long Beach* addressed an executive order requiring school districts to take specific steps in alleviating racial and ethnic segregation. The court recognized that school districts have a constitutional obligation to alleviate racial segregation. However, the court held that the specific requirements mandated by the executive order went beyond constitutional and case law requirements. In the present case, however, staff finds that the test claim legislation does not go beyond the just compensation clause of the Fifth Amendment and is, thus, distinguishable from *Long Beach*.

The Commission Has the Sole and Exclusive Authority to Determine Whether a Mandate Exists

Both the claimant and St. Mark's Episcopal Church cite the following language in the test claim legislation for the proposition that the legislature intended the test claim legislation to impose reimbursable state mandated costs:

“SEC 9. . . . *if* the Commission on State Mandates determines that this act contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made pursuant to Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code.” (Emphasis added.)

However, this legislative statement is *not* determinative or controlling of the ultimate issue as to whether the test claim legislation constitutes a reimbursable state mandated program under article XIII B, section 6. Rather, the Commission has the sole and exclusive authority for deciding this issue under article XIII B, section 6 of the California Constitution and section 17514 of the Government Code.³³ Moreover, staff submits that the Legislature recognized these principles with its use of the phrase “*if* the Commission on State Mandates determines...” in the express language of the statute.

Conclusion

Staff concludes that the test claim legislation does not impose a reimbursable state mandated program under article XIII B, section 6 of the California Constitution and Government Code section 17514 because:

- the exercise of the power of eminent domain is discretionary and not state mandated,
- once a local agency elects to acquire property that contains nonprofit, special use property, the downstream activities, including the statutory requirement to seek alternative property before negotiating with the owner and the payment of just compensation for the property taken, are *not* state mandated,
- evidence of additional costs alone without a corresponding increase in the level of service performed by a local agency does not result in reimbursement, and
- payment of “just compensation” under eminent domain is mandated by the U.S. Constitution.

Staff Recommendation

Staff recommends that the Commission deny this test claim.

³³ *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817-1818; *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 333; and Government Code section 17552 which states that “[t]his chapter [Chapter 4 entitled “Identification and Payment of Costs Mandated by the State] shall be the sole and exclusive procedure by which a local agency or school district may claim reimbursement for costs mandated by the state as required by Section 6 of Article XIII B of the California Constitution.”

Commission on State Mandates

Mailing List

20-Oct-98

CSM/SB# and Claim Title 97-TC-01 {97-238-01} Claim of the City of San Deigo

Government Code Sec. SB 821 wherein Code of Civil Proc. sections 1235.155 & 1263.321

Chapters Evidence Code section 824 was added and section 823 was amende

Issue Nonprofit, Special Use Property Requirements

Originated: 09-Sep-97

Mr. James Apps (A-15),
Department of Finance

915 L Street 8th Floor, Rm 8020
SACRAMENTO CA 95814

Tel: (916) 445-8913

FAX: (916) 327-0225

Ms. Debra J. Bevier, Deputy City Attorney
City of San Deigo

1200 Third Avenue Suite 1200
SAN DIEGO CA 92101

Tel: (619) 533-5889

FAX: (619) 533-5847

Mr. Donald W. Detisch, ESQ.
Detisch & Christensen
Attorneys at Law

444 West C Street, Suite 200
SAN DIEGO CA 92101

Tel: (619) 236-9343

FAX: (619) 236-8307

T.W. Boyer Legal Division MIC:83, Chief Counsel
State Board of Equalization

450 N Street P O Box 942879
SACRAMENTO CA 94279-0001

Tel: (916) 445-4380

FAX: (916) 323-3387

Mr. Paul Minney, Interested Party
Girard & Vinson

1676 N. California Blvd. Suite 450
WALNUT CREEK CA 94596

Tel: (925) 746-7660

FAX: (925) 935-7995

Ms. Sandy Reynolds, President (Interested Person)
Reynolds Consulting, Inc.

P.O. Box 987
SUN CITY CA 92586

Tel: (909) 672-9964

FAX: (909) 672-9963

Mr. Paige Vorhies (B-8),
State Controller's Office
Division of Accounting & Reporting

3301 C Street Suite 500
SACRAMENTO CA 95816

Tel: (916) 445-8756

FAX: (916) 323-6527

CSM/SB# and Claim Title 97-TC-01 {97-238-01} Claim of the City of San Deigo

Government Code Sec. SB 821 wherein Code of Civil Proc. sections 1235.155 & 1263.321

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Issue Nonprofit, Special Use Property Requirements

Originated: 09-Sep-97

Mr. David E. Wellhouse,
Wellhouse & Associates

9175 Kiefer Blvd Suite 121
SACRAMENTO CA 95826

Tel: (916) 368-9244

FAX: (916) 368-5723

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