

COMMISSION ON STATE MANDATES

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May 8, 1998

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

And Interested Persons

RE: Draft Staff Analysis of Test Claim
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

Dear Ms. Bevier:

The draft staff analysis of this test claim has been completed and is enclosed for your review and comment. Cases cited by Commission staff are also enclosed. The hearing on the test claim has been tentatively scheduled for June 25, 1998.

Written Comments

Any party or interested person may file written comments on the draft staff analysis by May 29, 1998. You are advised that the Commission's regulations require comments filed with the Commission to be simultaneously served on other interested parties (on the mailing list), and to be accompanied by a proof of service on those parties. If you would like to request an extension of time to file comments, please refer to section 1183.01 (c) of the Commission's regulations.

Hearing

This test claim is tentatively set for hearing on June 25, 1998 at 9:30 a.m. in Room 437 of the State Capitol, Sacramento, California. The final staff analysis will be issued by June 12, 1998. Please let us know in advance if you or a representative of your agency will testify at the hearing, and if other witnesses will also appear. If you would like to request postponement of the hearing, please refer to section 1183.01 (c) of the Commission's regulations.

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Test Claim Number

Please note that the number assigned to this test claim has been changed to 97-TC-01.

CSM Staff Assignment

Ms. Camille Shelton, Commission Staff Counsel, will be presenting this test claim at the June 25, 1998 hearing. Please call her at 323-3562-if you have any questions regarding the draft staff analysis or the hearing process.

Sincerely,



PAULA HIGASHI
Executive Director

c: Mailing List

Enc. Draft Staff Analysis of 97-TC-01 (Dated May 8, 1998) and
Cases cited by Commission staff

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Hearing Date: June 25, 1998
File Number: CSM-97-228-01
Commission Staff
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Draft Staff Analysis (Dated May 8, 1998)

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

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 be exercised, rather this power is left to the discretion of the governmental entity authorized to acquire the property.

The 5th 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 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. 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.

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.

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. St Mark's further contends that the court decision of *City of Merced* does not apply because that case 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 imposes additional costs when a local agency uses the power of eminent domain to condemn nonprofit, special use property.

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,
- 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 (claimant).
 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.

Test Claim Legislation

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.

Position of the Parties.

Rather than restate the positions of the parties, please refer to the Executive Summary.

Staff Analysis

Issue 1: 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. . . .*"

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.)

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.)²

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.³

The Exercise of the Power of Eminent Domain is Discretionary.

California's eminent domain law provides 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."*⁴ (Emphasis added.)

Despite the express statutory provisions of California law, the claimant argues that the exercise of eminent domain is state mandated. The claimant argues 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

² 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."

³ *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.

⁴ Code of Civil Procedure section 1230.030.

- 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*.⁵

Contrary to claimant's arguments, staff submits that the statutory provisions clearly spell out that the exercise of eminent domain is a discretionary act and not state mandated.

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* case⁶ 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 newly enacted statute that required the compensation for 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

⁵ 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 to answer 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. (*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.”)

⁶ *City of Merced v. State of California* (1984) 153 Cal.App.3d 777.

pay for loss of goodwill. Thus, payment for loss of goodwill is *not* a state-mandated cost." (Emphasis added.)⁷

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 incur the costs it claims, the agency is not entitled to reimbursement from the state. (Emphasis added.)⁸

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 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.⁹

In the situation at hand, 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, or the payment of lost goodwill for business 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.¹⁰ 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. For the most part, the test claim legislation did not mandate any higher level of service upon local agencies. Although the claimant can show additional costs

⁷ *Id.* at 783.

⁸ *County of Contra Costa v. State of California* (1986) 177 Cal.App.3d 62, 79-80.

⁹ *Lucia Mar Unified School Dist. v. Honig, supra*, 44 Cal.3d at 836-837; *County of Los Angeles v. Commission on State Mandates, supra*, 32 Cal.App.4th at 818.

¹⁰ *County of Los Angeles v. State of California, supra*, 43 Cal.3d 46, 56.

corresponding to the non-deductibility of depreciation, there is no new service or activity that must be provided by the local agency upon the exercise of eminent domain.¹¹

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.¹² The 5th 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.¹³

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 market¹⁴ 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.¹⁵ 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.

¹¹ The test claim legislation does require that before condemning the nonprofit, special use property, the local agency must seek alternative property prior to taking such property. Although this new activity is required, it does not come into play until after a local agency elects to take a nonprofit, special use property through eminent domain proceedings.

¹² 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."

"(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."

¹³ 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. *United States v. Toronto, Hamilton and Buffalo Nav. Co.* (1949) 338 U.S. 396, 402-403; *United States v. 100 Acres of Land in Marin County* (9th Cir. 1972) 468 F.2d 1261, 1265; and *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.

¹⁴ *United States v. 50 Acres of Land* (1984) 469 U.S. 24, 30.

¹⁵ *United States v. 564.54 Acres of Land in Monroe and Pike Counties, Pennsylvania* (1979) 441 U.S. 506, 513.

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.¹⁶

In *United States v. Board of Education*,¹⁷ 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 government should make it possible for the school to acquire other property to use in *substitution* for the property taken.”¹⁸

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.”¹⁹

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.]²⁰

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.

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.

¹⁶ *State of Washington v. United States* (9th Cir. 1954) 214 F.2d 33; *State of California v. United States* (9th Cir. 1968) 395 F.2d 261; *United States v. Los Angeles County* (9th Cir. 1947) 163 F.2d 124.

¹⁷ (4th Cir. 1958) 253 F.2d 760.

¹⁸ *Id.* at 763.

¹⁹ *Id.* at 763.

²⁰ *Id.* at 764.

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 to 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.)²¹

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 is not state mandated, but falls within the 5th Amendment's mandate of awarding just compensation to owners of nonprofit, special use property fashioned by the federal courts.²²

²¹ *Redevelopment Agency v. First Christian Church*, *supra*, 140 Cal.App.3d at p. 698.

²² 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.

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,
- 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.