

Business Improvement Districts and Proposition 218 After *Silicon Valley Taxpayers Association v. Santa Clara County Open Space Authority*

By Rebecca J. Olson & Lacey Keys*

I. INTRODUCTION

In 1996 the voters passed Proposition 218, an initiative measure that amended the California Constitution to require local governments to hold a vote of the affected property owners before any proposed new or increased assessment could be levied. Notwithstanding this limitation, courts have historically shown deference towards local governments when adjudicating challenges to new or increased assessments. A recent California Supreme Court case, *Silicon Valley Taxpayers Association v. Santa Clara County Open Space Authority*, 44 Cal. 4th 431 (2008) marks a shift away from the court's traditional deferential posture and recognizes that local governments bear the burden of proving that new or proposed assessment will provide a special benefit proportional to the amount of property owned by those subject to it.

This article focuses on the impact that *Silicon Valley* is likely to have on the establishment of business improvement districts. The first part provides an overview of business improvement districts and briefly describes the history of the districts in California. The remainder of the article discusses *Silicon Valley* and its impact on future districts in the State, and offers practical guidelines for counsel advising potential business improvement districts.

II. OVERVIEW OF BUSINESS IMPROVEMENT DISTRICTS

A Business Improvement District (BID)¹ is created to raise money for neighborhood improvements and is established when a group of property owners decide by a majority vote to assess themselves.² The local government collects the assessment, along with other taxes, and then apportions assessment proceeds to the BID's operating organization.³ BIDs are typically operated by a nonprofit organization, a quasi-public authority, or a mixed public-private enterprise.⁴

BIDs provide their assessed community with

various services, including: capital improvements (e.g., installing pedestrian lighting and planting trees); consumer marketing (e.g., creating and publicizing local events); economic development in the form of incentives for new and expanding businesses; maintenance of streets, sidewalks and graffiti removal; managing public parking and transportation; promoting public policies beneficial to the district; supplementary security services (e.g., security guards and cameras); and some social services.⁵ BIDs engage in these types of activities based on their size, budget and organizational structure.⁶

A. PROS AND CONS

The impetus behind the development of BIDs was the dilapidated state of many urban centers.⁷ In the 1960s local governments began to focus on social welfare and "turned their backs on the key missions of policing and sanitation."⁸ As a result, customers fled to suburban shopping malls and urban businesses suffered.⁹ BIDs sprang up as urban businesses' response to these issues. With their focus on security and cleanliness, BIDs can provide a unique private sector solution to public problems.

Many people view the development of BIDs as a success because they provide cleaner, friendlier and safer urban areas.¹⁰ They point to BID's potential to prioritize safety and cleanliness issues, and to the fact that they are not hampered by civil service rules and are able to negotiate labor contracts freely.¹¹

Critics of BIDs suggest that the assessments are a second tax for services a city is already required to provide.¹² Other critics point to higher property values, which displace the poor and lead to gentrification.¹³ Still others argue that BIDs effectively lead to harassment of the homeless.¹⁴ Despite these critiques, BIDs are credited with having helped clean up urban areas as large as New York City and as small as Burlingame, Maine.¹⁵

III. HISTORY OF BUSINESS IMPROVEMENT DISTRICTS IN CALIFORNIA

BIDs came to California with the Property and Business Improvement District Law of 1994.¹⁶ Before 1994, the Parking and Business Improvement Area Law of 1989 permitted a city to establish a parking and business improvement area in order to levy benefit assessments on business owners for the purpose of funding certain enumerated improvements and activities.¹⁷ The Downtown Economic Improvement Coalition sponsored the Property and Business Improvement District Law of 1994, because existing legislation did not assess property owners and did not authorize the business improvement areas to provide all the services necessary to improve urban centers.¹⁸ Therefore, the 1994 legislation supplements the 1989 legislation by authorizing the creation of districts to levy assessments on both business and property owners, and by expanding the services such districts could provide.¹⁹ Proponents of the 1994 legislation pointed to reinvestment in downtown locations and local self-help as reasons for the legislation,²⁰ while opponents worried it was an attempt to circumvent Proposition 13's two-thirds vote requirement for a special tax.²¹ However, the bill ultimately passed and was chaptered on September 27, 1994.

In 1996, California voters passed Proposition 218²² to stop perceived abuses in the use of assessments, namely their use to raise revenue for general governmental services other than property-related services.²³ Proposition 218 thus imposed stricter requirements to establish a BID and assess property owners.

To establish a BID, the proponent(s) must follow a specific procedure including notice, public hearings and weighted voting.²⁴ The proposed BID and assessment also must be supported by a detailed engineer's report.²⁵ This procedure shifts power over local assessment to local property and business owners.²⁶

To be valid, an assessment must meet two substantive requirements.²⁷ First, the BID must confer a special benefit on the assessed properties over and above those conferred on all properties in the district or on the public at large.²⁸ Proposition 218 makes clear that only special benefits are assessable, so general benefits must be separated and funded by alternative sources. Second, each parcel may only be assessed an amount proportional to the special benefit it receives.²⁹ The proportionate special benefit for a given parcel is determined "in relationship to the entirety of the capital cost of a public improvement, the maintenance and operation expenses of a public improvement or the cost of the property-related services being provided."³⁰ Significantly, Proposition 218 places the burden of proving special benefit and proportionality on the proponents of a BID,³¹ eliminating the prior presumption that an assessment was valid.³²

Proposition 218 applies to local governments, which includes any county, city, city and county, including a charter city or county, any special district or any other local or regional governmental entity.³³ Special districts include redevelopment agencies, school districts and any other agency of the State for the local performance of governmental or proprietary functions with geographic boundaries.³⁴ Proposition 218 expressly *does not* exempt from assessment properties owned or used by local, state or federal government.³⁵ To establish an exemption, a governmental entity must show that it receives no special benefit from the BID by clear and convincing evidence.³⁶

IV. SILICON VALLEY TAXPAYERS ASSOCIATION V. SANTA CLARA COUNTY OPEN SPACE AUTHORITY

In *Silicon Valley Taxpayers Association*, the California Supreme Court considered the validity of a 2001 assessment district created by the Santa Clara Open-Space Authority (OSA).³⁷ OSA was established before the passage of Proposition 218 by the Santa Clara County Open-Space Authority Act to acquire and preserve open space in the County.³⁸ OSA's original assessment district was established in 1994 under the Landscape and Lighting Act of 1972.³⁹

In 2001, OSA determined additional funding was needed to establish additional open spaces and began adoption of a new assess-

ment district.⁴⁰ OSA attempted to follow the procedural requirements of Proposition 218 by providing notice, holding a public hearing, and weighting the votes.⁴¹ The engineer's report listed seven "special benefits" that the assessment would confer on *all* residents and property owners in the district: (1) enhanced recreational activities and expanded access to recreational areas; (2) protection of views, scenery, and other resources; (3) increased economic activity; (4) expanded employment opportunity; (5) reduced costs of law enforcement, health care, fire prevention, and natural disaster response; (6) enhanced quality of life and desirability of the area; and (7) improved water quality, pollution reduction, and flood prevention.⁴² The engineer's report set the assessment for a single family home at \$20, based on OSA's survey regarding the amount property owners would be willing to assess themselves. OSA calculated the assessment would produce about \$8 million annually for its budget.⁴³

The new OSA assessment district passed and was established on December 31, 2001.⁴⁴ Silicon Valley Taxpayers Association, Howard Jarvis Taxpayers Association and several individual taxpayers (collectively "plaintiffs") challenged the 2001 assessment district procedurally and substantively.⁴⁵ After the OSA board renewed the district for 2003-2004, the plaintiffs challenged that action as well and the cases were consolidated.⁴⁶ The court granted OSA summary adjudication and entered judgment in favor of OSA. The Court of Appeal affirmed, holding that although Proposition 218 eliminated the presumption that assessments are valid, courts should still accord the local government's determination substantial deference if Proposition 218's procedural requirements were followed and substantial evidence in the administrative record supported the finding that the benefits were special.⁴⁷

A. NEW STANDARD OF REVIEW

The California Supreme Court revised and adopted a different standard of review: "courts should exercise their independent judgment in reviewing local agency decisions that have determined whether benefits are special and whether assessments are proportional within the meaning of Proposition 218."⁴⁸ In so doing, the Supreme Court relied on the plain language and history of Proposition 218.

The text of Proposition 218 provides, "[i]n any legal action contesting the validity of any

assessment, the burden shall be on the agency to demonstrate that the property or properties in question receive a special benefit over and above the benefits conferred on the public at large and that the amount of any contested assessment is proportional to, and no greater than, the benefits conferred on the property or properties in question." Prior to the passage of Proposition 218, the courts exercised a deferential, abuse of discretion standard in adjudicating challenges to special benefit assessments of.⁴⁹ After Proposition 218 was passed, few cases dealt with the standard of review applicable to assessments.⁵⁰ However, the few courts that did address the issue upheld a local government's determination whether affected properties received a special benefit proportional to the assessment so long as substantial evidence supported that determination.⁵¹ This standard was highly deferential to local judgment.⁵²

In *Silicon Valley Taxpayers Association*, the Supreme Court recognized that Proposition 218 was a response to the deferential standard used by the courts and was designed to shift the burden of proof to the proponents of an assessment and to make it easier for taxpayers to win lawsuits.⁵³ The Court of Appeal in this case used a less deferential standard than the earlier abuse of discretion standard. The Supreme Court held the lower court misinterpreted Proposition 218 by ignoring the substantive requirements of the proposition.⁵⁴ The court held that reviewing courts must undergo their own independent review under Proposition 218 to determine whether an assessment actually confers special benefits on assessed property owners and whether the amounts assessed are proportional to the benefits conferred.⁵⁵

This decision marks a shift from the court's traditional deferential standard of review for special assessments. A local government establishing a BID must be more cognizant of the engineer's report and whether it adequately establishes special benefits to be received by each parcel. Additionally, the local government must determine whether the report adequately describes the nexus between each parcel's benefit and assessment. This fact may increase the costs of establishing a BID and may encourage opponents to challenge new BIDs. When a BID is challenged, it will be the local government's burden to prove a special benefit exists and that the assessment is proportional to the special benefit.

B. SPECIAL BENEFIT

Proposition 218 defines a "special benefit" as a particular and distinct benefit over and above general benefits conferred on real property located in the district or to the public at large and clarifies that general enhancement of property value does not constitute "special benefit."⁵⁶ In *Silicon Valley Taxpayers Association*, the court emphasized that Proposition 218 says general enhancement of property value does not constitute a "special benefit" and only special benefits are assessable.⁵⁷ Prior to Proposition 218, courts did not invalidate assessments that conferred general benefits along with specific benefits and they did not require BIDs to separate the two.⁵⁸ The court opined that reliance on these pre-Proposition 218 cases was unwarranted because the California Constitution now explicitly requires otherwise.⁵⁹ Based on these principles, the OSA assessment was invalid because the benefits listed in the engineer's report were general benefits conferred on all parcels in the district.⁶⁰ Especially troublesome for the court was the report's failure to measure the benefits to particular parcels.⁶¹

Although not beneficial to OSA's district, the court noted "in a well-drawn district - limited to only parcels receiving special benefits from the improvement - every parcel within that district receives a shared special benefit."⁶² As the court did not believe voters meant to invalidate such a narrowly drawn district, it stated, "if an assessment is narrowly drawn the fact that a benefit is conferred throughout the district does not make it general rather than special." This statement provides a safe haven for narrowly drawn districts and creates incentive to draw BIDs narrowly.

C. PROPORTIONALITY

With regard to the second substantive requirement, the court found OSA was not able to demonstrate proportionality.⁶³ The engineer's report assigned each property a single family equivalent (SFE) based on the number of people expected to use the property and a value of \$20 to each SFE.⁶⁴ The report listed 30 priority acquisitions; however it did not ensure any of them would be made or that OSA would regularly make acquisitions. The court found this did not establish proportionality because it assumed all single-family homes would receive the same benefit, regardless of location in the district and proximity to

open spaces.⁶⁵ OSA argued its plan to acquire open spaces evenly throughout the district established proportionality. However, the court disagreed because the report failed to identify with sufficient specificity the permanent public improvement to be financed by the assessment, failed to estimate or calculate the cost of the improvement and failed to connect the costs and benefits of the improvements to the specific properties to be assessed.⁶⁶

V. PRACTITIONER TIPS

A. DETAIL SPECIAL BENEFITS FOR SPECIFIC PARCELS

The district plan can consist of, but is not limited to: a description of the boundaries of the district, an outline of the service plan, a budget, the methodology of the assessment, a timeline, and a description of the future management of the district. Practitioners should advise their clients to carefully draft the assessment and assessment methodology portions of a plan to avoid hitting the pitfalls that gave rise to the *Silicon Valley* case.

A district plan should ensure it is demonstrating the provision of special benefits for the parcels in the district, and not just enhancing all properties generally. By breaking down the district itself into smaller benefit zones and detailing how each zone will benefit from the services the district provides, a district can show it is providing special benefits.

B. ENSURE BENEFITS ARE APPLIED PROPORTIONALLY

The plan should detail exactly which parcel appears in which zone, the address of that parcel, the annual assessment that will be levied based on the zone and the level of benefits it will receive. By breaking down the district into zones and applying assessments based on the type of parcel and which zone it is in, a district's report will serve as evidence of the special benefits each parcel will receive.

A plan that details that a particular zone within the district is made up primarily of a specific type of parcel, such as residential, public or retail, will show that a particular zone will require limited, moderate or extensive services. The level of services a particular zone of parcels will receive should be directly related to the amount a parcel in that zone should

be assessed.

VI. CONCLUSION

Practitioners and local government officials should be cognizant of the shifting burden established by the California Supreme Court in *Silicon Valley*. After this decision, local governments must ensure that proposed business improvement districts assess the parcels in the district in proportion to the benefits each will receive, as well as ensure the benefits those parcels are receiving are true "special" benefits and not the general benefits the locality as a whole will receive. Some may argue that while this decision marks a shift in the burden of proof, the court was merely adhering to the language established in 1996 when the voters passed Proposition 218. Either way, local governments will bear the burden of proving their proposed district meets the requirements of 218 if challenged in court.

ENDNOTES

1. "Business Improvement District" is but one term for the type of entity discussed in this article. Other terms include special improvement district, public improvement district, and community benefit district, among others.
2. Heather Mac Donald, *Why Business Improvement Districts Work*, 4 CIVIC BULLETIN, Manhattan Inst. for Pol'y Res. (1996), available at http://www.manhattaninstitute.org/html/cb_4.htm.
3. Jerry Mitchell, *Business Improvement Districts and Innovative Service Delivery*, pg. 9. Available at <http://www.businessofgovernment.org/pdfs/Mitchell.pdf>.

Endnotes continued on page 31

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4. Mitchell, *supra* note 3, at 7.

5. *Id.* at 18.

6. *Id.* at 19.

7. Gordon Marshall, Business Improvement Districts, *DICTIONARY OF SOCIOLOGY*, (1998).

8. Mac Donald, *supra* note 2.

9. *Id.*

10. See, e.g., Marshall, *supra* note 7; see also Erin Ailworth and William Wan, *Flak Over Downtown Security Guards*, *LOS ANGELES TIMES*, June 8, 2004 at B-1.

11. Mac Donald, *supra* note 2.

12. *Id.*

13. Marshall, *supra* note 7.

14. Ailworth, *supra* note 10.

15. <http://www.mass.gov/Ehed/docs/dhcd/cd/bid/faq.doc>

16. Cal. Str. & Hwy. Code §36600, *et seq.* (West 2008).

17. Cal. Str. & Hwy. Code §36500, *et seq.* (West 2008).

18. AB Comm. on Local Gov't, at 6 (Apr. 20, 1994).

19. *Id.* at 1.

20. *Id.* at 7-8.

21. AB Floor Analysis, at 6 (June 30, 1994).

22. Cal. Const. Art. XIIIID.

23. Legislative Analysts Office, *Understanding Proposition 218* (1996), available at http://www.lao.ca.gov/1996/120196_prop

_218/understanding_prop218_1296.html#chapter1 (hereinafter LAO).

24. Cal. Const. Art. XIIIID, §4(c)-(e); see also Cal. Gov. Code § 53753 (West 2008).

25. Cal. Const. Art. XIIIID, §(4)(b).

26. LAO, *supra* note 23.

27. Cal Const. Art. XIIIID, §4.

28. *Id.* at §4(a).

29. *Id.*

30. *Id.*

31. *Id.* at §4(f).

32. *Silicon Valley Taxpayers Association v. Santa Clara County Open Space Authority*, 44 Cal. 4th 431, 79 Cal. Rptr. 3d 312, 321 (2008).

33. Cal. Const. Art. XIIIID, §§1(a), 4(a). See also Cal. Const. Art. XIIIIC(1)(b).

34. Cal. Const. Art. XIIIIC(1)(c).

35. Cal. Const. Art. XIIIID, §4(a).

36. *Id.*

37. 79 Cal. Rptr. 3d (2008).

38. *Id.* at 318.

39. *Id.*

40. *Id.*

41. *Id.* at 319.

42. *Id.* at 330.

43. *Id.* at 319.

44. *Id.*

45. *Id.*

46. *Id.* at 320.

47. *Id.*

48. *Id.* at 327-28.

49. *Id.* at 322.

50. See *Dahms v. Downtown Pomona Property and Business Improvement District*, 41 Cal. Rptr.

3d 196,199 (2d Dist. 2006).

51. *Id.*

52. *Id.*

53. *Id.* at 323.

54. *Id.* at 327.

55. *Id.*

56. Cal. Const. Art. XIIIID, §2(i).

57. *Silicon Valley Taxpayers Association*, 79 Cal. Rptr. 3d at 329.

58. *Id.*

59. *Id.*

60. *Id.* at 330.

61. *Id.*

62. *Id.* at 329, n 8.

63. *Id.* at 333.

64. *Id.*

65. *Id.*

66. *Id.*