Commentary

Preserving Entitlements with Tax-Exempt Bond Financing

by Gary P. Downs

Slowing or delayed development because of current economic trends causes many economic woes for a property owner. Such grief is exacerbated when the landowner has entitlements which expire or may change because improvements are not constructed according to a public entity's time schedule. Economic limitations on the construction of such facilities may cause the loss of those entitlements forever. The article "Staying Alive - Preserving Subdivision Entitlements in the '90's" in last fall's *Perspectives* dealt with the question of subdivision entitlements expiring by operation of the Subdivision Map Act.

This article discusses the expiration of limited life entitlements provided by agreement or the possible change of entitlement by a public entity and the issuance of tax-exempt bonds. Tax-exempt bonds must be issued by a public entity but in many circumstances the proceeds will be used to construct improvements on land which benefit only a few property owners. In such cases the bonds are secured by special taxes or assessments on the land of such property owners. The issuance of tax-exempt bonds secured by land in the land owner's project may protect entitlements. In addition, the issuance of such bonds may create in the public entity granting the entitlements certain practical concerns which limit the ability of the public entity to revoke entitlements.

It is clear that California law will protect entitlements against initiative measures, such as slow growth initiatives, which may impede the security of the bonds so as to cause a likely default. This same law will not, however, protect against expiring entitlements because of delayed construction or a change by the public entity in land use regulations.

The Furey Test

The California Supreme Court in *Furey v. City of Sacramento* found that a developer was entitled to relief from the application of a land-use regulation that had the effect of drastically decreasing the benefit of sewer improvements which were financed by tax-exempt bonds. In *Furey*, the County of Sacramento contemplated in the early 1960's the transition of an entire area to urban development and uses and undertook the establishment of a special sewer assessment district, which was to install various sewer facilities. The land was thereafter annexed to the City of Sacramento. In 1972, the City of Sacramento imposed a moratorium on building and development in the area in which Furey's property was located. Then, in 1973, the City adopted an "Open Space Element" into its general plan indicating that Furey's land would be reserved for agricultural and open space uses. Furey thereafter requested that all assessments be repaid to him and that he be relieved of paying any further assessments. The City took no action pursuant to the requests. The Supreme Court found that the government could not impose a moratorium on improvement where the landowner has been assessed for bonds and where the assessment is based on the benefit to be obtained from the eventual improvement of the landowner's land. The court, however, distinguishes this case from a case in which the construction of public improvements is undertaken on the initiative of the property owner himself.

The question of whether Furey initiated the sewer improvement was later raised in a federal court. That court found that Furey's sewer assessment constituted a voluntary private investment because Furey participated in the initiation of the sewer improvements. The court expanded on the California Supreme Court's decision by finding that although the question of who initiated the improvement is important, the determination should take into account all of the facts and circumstances surrounding the levying of an assessment. The court laid out a number of factors to consider when deciding which entitlements need to be protected because of the issuance of tax-exempt bonds secured by assessments.

These factors include (i) whether the assessment was initiated by the government or by the owners of the assessed property, (ii) whether the government actively induced or promoted the assessment, (iii) whether the property of any nonconsenting landowners was subject to the assessment, (iv) whether the design of the improvement was under the control of the assessed landowners or reflected their intentions and needs, and (v) whether the improvement was designed to yield substantial benefits to the public at large.

In the application of this test, if substantial government action is found in any one of these areas, the government must pay for any taking of property caused by a change in its development policy. A land owner who seeks protection under the *Furey* line of reasoning should then be careful to not exert too much control over the improvement being built with the proceeds of tax-exempt bonds.

Practical Considerations

Issuance of land-secured bonds may also provide practical barriers to revocation of entitlements by a public entity. Although the public entity who issues the bonds is typically not liable for land-secured bonds, default on such bonds caused by a withdrawal of entitlements may affect the public entity's credit rating. Furthermore, most public entities prefer not to be involved in diminishing security for bondholders.

A carefully planned bond issuance and public construction project with bond proceeds may, thus, provide certain legal protection against diminishing entitlements. More importantly, the existence of tax-exempt bonds secured by entitled or semi-entitled land provide effective practical barriers against a public entity changing the entitlements.

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