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Redevelopment in California: The Demise of
TIF-Funded Redevelopment in California and
Its Aftermath

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George Lefcoe and Charles W. Swenson

Abstract

California was the first state to embrace the use of tax increment financing (TIF) for redevelopment, and the first state to abandon it. Both the rise and fall of redevelopment are attributable to the fact that cities and counties sponsoring redevelopment could pledge not just their own share of the property tax increments from redevelopment project areas but also those of the other taxing entities including schools and special districts.

By voter initiative in 1978, California enacted significant limitations on the property tax, cutting property tax revenues by half. The property tax had been the most important revenue source for local governments and education. But Proposition 13 barred local governments and school boards from raising tax rates to cover their budget needs. Many cities and a few counties realized that through redevelopment, they could capture tax increments from other taxing entities including schools.

At about the same time, a landmark court decision and a voter initiative imposed upon the state the legal obligation to back fill school budgets. To fund schools, the state siphoned property tax and other traditionally local revenue sources away from local governments and their redevelopment agencies.

Local governments and redevelopment agencies pushed back and launched a successful ballot box measure known as Proposition 22 to prohibit further state raids on redevelopment agency TIF. In 2011-12, during a declared fiscal emergency, facing a 25 billion dollar deficit, Governor Brown seized the political moment to

put an end to redevelopment which had been diverting \$5 billion a year in property tax revenues he felt would be put to better use for education and other public needs. Proposition 22 precluded the state clawing back TIF revenues from redevelopment agencies as long as they existed.

Governor Brown championed RDA dissolution, and the state legislature eventually agreed after they enacted a companion measure offering RDAs a chance to survive but only by forgoing most of the TIF that would have gone to schools and special districts.

RDAs and the League of California Cities sued, contending that this “pay to stay” option violated Proposition 22. When the California Supreme Court agreed with them, RDAs had foreclosed their only option to dissolution. They could accept this outcome because cities were once limited to accessing only their own tax money, they could achieve much of what redevelopment had allowed, free of the cumbersome costs and constraints of state redevelopment law.

REDEVELOPMENT IN CALIFORNIA: THE DEMISE OF TIF-FUNDED REDEVELOPMENT IN CALIFORNIA AND ITS AFTERMATH

George Lefcoe and Charles W. Swenson

California was the first state to embrace the use of tax increment financing (TIF) for redevelopment and the first state to abandon it. Both the rise and fall of redevelopment are attributable to the fact that cities and counties sponsoring redevelopment could pledge not just their own share of the property tax increments from redevelopment project areas, but also those of the other taxing entities including schools and special districts. At a time of a projected state deficit of \$25 billion, Governor Brown seized the political moment to put an end to redevelopment and the \$5 billion a year in property tax revenues he felt would be put to better use for education and other public needs. This paper describes the unique setting and subsequent events leading to the end of TIF in California and its aftermath.

Keywords: tax increment financing, redevelopment areas, property taxes, California taxes

JEL Codes: H1, H2, H7

I. TAX INCREMENT FINANCING IN THE EARLY YEARS OF REDEVELOPMENT IN CALIFORNIA

Tax increment financing (TIF) refers to a process of paying for redevelopment activity with anticipated increased property tax revenues from the redevelopment project itself. TIF gained political acceptability in the early 1950s in California because it required no new taxes. TIF proceeds were drawn entirely from higher property taxes assessed upon future owners of property within redevelopment project area boundaries.

California redevelopment was first authorized in 1945 when the state legislature enabled cities and counties to establish redevelopment agencies (RDAs).¹ The objec-

¹ Cities and counties were authorized to establish redevelopment agencies by the Community Redevelopment Act of 1945. This law is known as the California Community Redevelopment Law (CRL). Redevelopment agencies were dissolved in 2011, as discussed by Taylor (2012).

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tive of early redevelopment was to halt the middle class exodus from central cities that had accelerated after World War II. The idea of funding redevelopment with tax increments came later.

RDAs assembled underutilized sites, cleared them of older buildings, and installed the infrastructure needed to support what real estate appraisers would call “higher and better” uses at these urban locations. This land would then be sold at fair market value to private developers prepared to construct projects consistent with the locality’s renewal plans and aspirations. The idea was to make urban sites available for private redevelopment at prices comparable to those of “green field” sites in rapidly growing suburbs. To facilitate this, government subsidies covered the gap between what it had cost to put the land into immediately buildable condition and what developers were willing to pay for it (Slayton, 1960). From 1949 through 1974, the federal government provided approximately \$53 billion (in 2009 dollars) in grants to cities for housing and urban redevelopment projects (Collins and Clum, 2011). Federal grants were contingent on local governments raising matching shares, and California led the way in utilizing TIF for this purpose. By leveraging TIF revenues with much larger federal grants, huge increases in assessed property values could be anticipated in core downtown areas where high density office and commercial projects would displace low density, low income, dilapidated housing.

For decades, leading policy makers disregarded the social costs of this dislocation.² But changes were eventually made on the federal, state, and local levels. The federal government enacted a uniform relocation law.³ On the state and local level, California mandated that 20 percent of all tax increment funds be set aside to preserve the supply of affordable housing,⁴ the redevelopment law imposed various constraints on the condemnation of homes, and RDAs became more sensitive to the issues of displacement.

Other taxing entities went along with these measures in the hope that rejuvenating center cities with capital-intensive redevelopment would eventually reverse their declining fortunes and significantly raise property tax revenues. The other taxing entities would continue to receive their pre-redevelopment levels of property tax revenues. They would only be deprived of the tax “increment,” which was defined as the increase in the tax base within the redevelopment project boundaries.

² Gans (1962) provides a classic depiction of how slum clearance destroyed a diverse, vibrant lower and working class neighborhood in Boston’s west end.

³ The Uniform Relocation Assistance and Real Property Acquisition Policies for Federal and Federally Assisted Programs, 42 U.S. Code Ch. 61.

⁴ The Los Angeles County Government Redevelopment Dissolution (<http://redevelopmentdissolution.lacounty.gov/wps/portal/rdd/about>) states, “The 20 percent set aside was held in a Low and Moderate Income Housing Fund.” Assembly bill ABX1 26 (http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_0001-0050/abx1_26_bill_20110629_chaptered.html) directs the county auditor-controller to distribute the unencumbered balance in the housing fund as property tax proceeds to the affected local taxing entities. This disposition of unused housing fund money underlines the close connection in the minds of legislators between TIF funded redevelopment and the TIF 20 percent set aside for affordable housing.

RDAs could raise capital by issuing tax allocation bonds (TABs). They thus did not have to borrow money from the sponsoring local government to raise their lump sum matching share. Bond investors would be repaid entirely from the anticipated tax increments.

A. The Redevelopment and TIF Enabling Amendment

TIF was made possible when California voters approved a constitutional amendment (Article XVI, section 16), which became effective in 1952. This measure facilitated TIF-funded redevelopment in two ways. First, although it did not impose any requirements on the legislature, the amendment gave the legislature the prerogative of enacting a law that would grant local RDAs the TIF option described above.

Second, the amendment freed TIF from a state constitutional requirement of voter approval for the issuance of public long-term debt guaranteed by the “full faith and credit” of the issuing government. This was justified because TAB bondholders would have no claim against the general funds secured by the full faith and credit of local or state governments. They would only be entitled to repayment from the property taxes in excess of pre-redevelopment levels, if any, collected from property owners within redevelopment project areas. Bondholders, not taxpayers, would bear the risk of tax increment shortfalls. The ensuing legislation was upheld in a seminal bond validation proceeding involving the Bunker Hill redevelopment project that sparked a rejuvenation of downtown Los Angeles.⁵

When the federal urban renewal grant program ended, California cities continued to finance redevelopment, mainly with tax increments.

II. IMPLICATIONS OF PROPOSITION 13 FOR REDEVELOPMENT

A. The Tax Revolt That Led to Proposition 13

On June 6, 1978, California voters by a two-to-one margin approved Proposition 13 (Cal-Tax Research, 1993). This measure added a provision to the California Constitution that placed significant limitations on property taxes.

Before Proposition 13, California tax assessors had routinely adjusted tax-assessed values to current fair market value. In housing booms, homeowners were burdened with huge property tax hikes. A tax revolt was sparked by property tax increases in 1975–1977, with house prices climbing 28 percent in 1977 alone (California Association of Realtors, 2005). Proposition 13 has since saved many homeowners from ballooning property tax bills in frothy housing markets (Peper, 1992).

⁵ Redevelopment Plan for Bunker Hill Urban Renewal Project 1B, 61 Cal. 2d 21 (1964).

B. How Proposition 13 Changed Property Tax Rates and the Tax Base in California

Under Proposition 13, annual property tax rates were capped at 1 percent (plus enough to repay bonded indebtedness). The tax base was rolled back to 1975 levels of fair market value. Valuations could only be increased following a change in ownership or for new construction except for an annual across-the-board inflation adjustment of 2 percent — but only if inflation equaled or exceeded that level. A subsequent law explicitly allowed reductions in assessed values that exceeded fair market value.⁶

C. Impacts of Proposition 13: A Buffer Against Gentrification

Proposition 13 was a buffer against the negative effects on low income households that often occurred when middle and upper income home buyers flocked to lower income neighborhoods. These newcomers pushed prices higher in formerly low income areas, and some long-time residents were forced out by higher property taxes they could not afford.

Cities outside California that had worked hard to attract young professionals to downtown areas are now considering reducing or freezing property tax increases to avoid displacing working and lower middle class homeowners threatened with rising taxes. Proposition 13 does this automatically by not adjusting property tax valuations to current market levels until property owners sell. This stabilizes neighborhoods by increasing the average tenure of all homeowners and renters, and increasing the average tenure of African-American homeowners and renters disproportionately (Wasi and White, 2005).

D. Reduced Revenue Volatility and Increased Stability

Proposition 13 also reduced the volatility of property tax revenues. Post-Proposition 13 assessed values are slow to rise in housing booms or to fall in real estate recessions. In particular, Cal-Tax Research (1993) reports that, “Property tax revenue flow has been 2.9 times more stable than pre-Proposition 13 property tax collections.”

Property tax revenues in California actually grew during the recent housing recession. For instance, in 2007–2009, property tax revenues in California increased just over 5 percent while other sources of tax revenue declined, with personal income tax revenues falling by 20 percent, corporate tax revenues by nearly 15 percent, and sales and use tax revenues by 11 percent.⁷

⁶ Proposition 8, an amendment to Article XIII A of the California Constitution, provides for temporary reductions in the taxable value of real property whenever its fair market value is lower than its indexed base value on the January 1 lien date.

⁷ Lutz, Raven, and Shan (2010, pp. 15–16) note, “Because Proposition 13 has created a large wedge between market values and assessed values, it will likely take a very long time for assessed values to catch up with market values. If that does occur, the legislated cap on the tax rate would cause property tax revenues to fall.” In most states, property values rose during the real estate recession of 2008–2009 (Legislative Analyst’s Office, 2012).

Tax revenue stability is why bond guarantors prefer California redevelopment agency bonds to those of states where property tax revenues tend to rise and fall with changing property values.

E. Proposition 13 Reduced Local Government and School Funding

Proposition 13 cut local government property tax revenues in half and diminished school funding by 60 percent.⁸ Before 1978, under the California Constitution, if a school district, special district or county lacked enough property tax revenue to cover its anticipated budget needs, the solution was simple. Their governing officials had the option of raising the taxing entity's property tax rate so that when multiplied by assessed property values, enough tax revenue would be available to finance its budget.

One feature of Proposition 13, little noticed before it took effect, empowered the state government to allocate property tax revenues among taxing entities since the law precluded each of them from setting its own tax rate autonomously. Under state law, the amount of property tax received by a local agency is a function of its relative share of property tax levied prior to Proposition 13. For example, a city that previously had a relatively high tax rate receives a larger share of the revenue raised by the fixed countywide 1 percent property tax rate (Chapman, 1998).

F. Cities Saw TIF-Funded Redevelopment as a Way to Make Up for Proposition 13 Property Tax Losses

Redevelopment in California would never have become so widespread but for Proposition 13. Desperate for replacement revenues, cities (and a few counties) saw an opportunity to fill their depleted property tax coffers by culling property taxes from other taxing entities (Fulton and Shigley, 2005). In the 1960s and 1970s, few communities established RDAs, and project areas were compact — usually 10 to 100 acres (Legislative Analyst's Office, 2011, p.1). Under the complicated tax allocation formulas passed by the state legislature, city shares of the property tax ranged from 5 to 20 percent with most of them ranging between 10 and 15 percent.⁹

Utilizing TIF, a city redevelopment agency could increase its share of the total property tax increment. Many cities formed RDAs for the first time, and RDAs, old and new, expanded boundaries. For instance, the city of Los Angeles' signature redevelopment project, Bunker Hill, initially contained 133 acres. After Proposition 13, virtually all of downtown Los Angeles was placed in one of nine redevelopment project areas, a total

⁸ These reductions led to calls for reform. For example, a group called "Close the Loophole" (http://closethe_loophole.com/about_us) campaigned to create a split assessment property tax role in which homeowners would continue to receive the benefits of Proposition 13 but commercial properties would be assessed at current fair market values.

⁹ These figures were obtained during an interview by the authors with John Naimo, Acting Los Angeles County Auditor-Controller, April 18, 2014.

of 5,475 acres within redevelopment project boundaries.¹⁰ In reality, redevelopment project areas had become little more than TIF districts.

In the 1970s, the state government became the financier of last resort for schools, forced into this position as a result of a court decision and voter initiatives (Lefcoe, 2012). Until then, schools and community college districts, which would receive about half of any growth in property tax revenues, had often lobbied to restrain RDA expansion. They became less engaged once the State made up any property tax revenue shortfalls.

G. Ineffective State Controls on Criteria for the Creation and Expansion of Redevelopment Project Areas

Though state laws set stringent criteria for how redevelopment area designations had to be justified, state enforcement depended on limited resources and required actions by private litigants, who were few and far between. This freed cities and counties to set boundaries for redevelopment project areas as they wished.

For some perspective on RDA growth, Figure 1 shows the number of RDAs created by decade. The 1970s and 1980s saw the creation of 80 percent of the RDAs in existence. The size of individual projects grew as well: in 1966 there were 27 project areas, all smaller than 200 square acres (one-third square mile); by 2008 there were numerous projects exceeding 20,000 acres (over 30 square miles). By 2000, RDAs comprised 1,868 of the state's 7,162 Census tract areas (or 26.1 percent). Some of the areas are quite large and clearly do not focus exclusively on urban areas.¹¹ Figure 2 shows the increasing share of the state's property taxes going to RDAs, which increased from less than 2 percent in the 1960s to 12 percent by 2000.

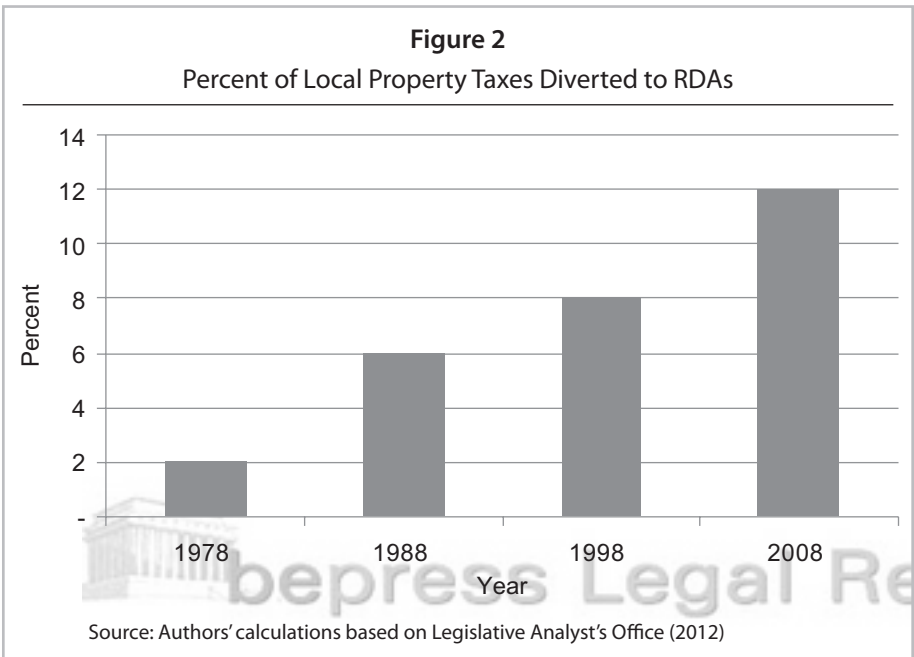
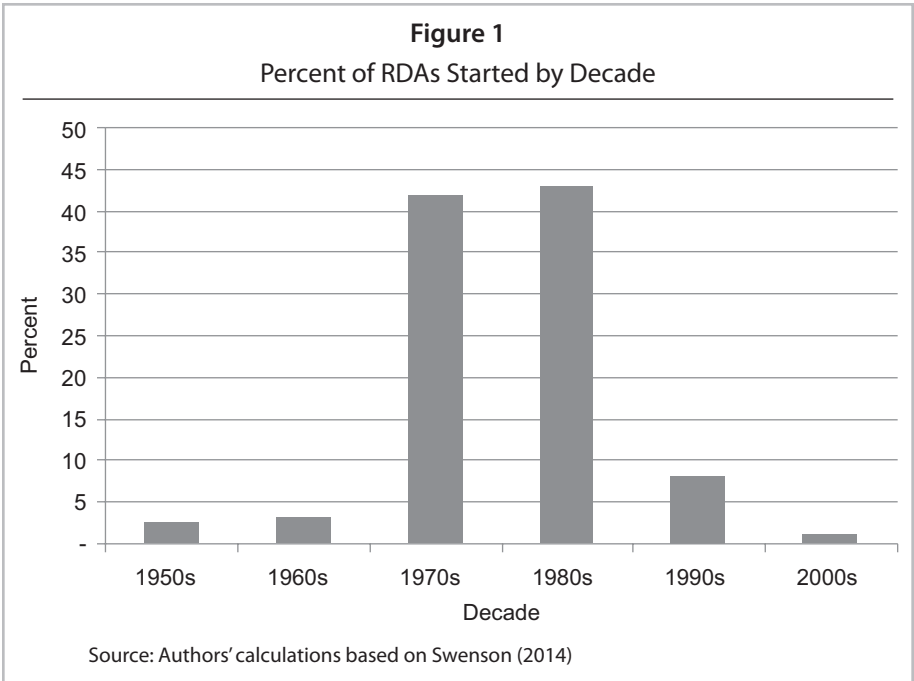
H. The Futility of Statutory Efforts to Impede the Spread of RDAs

By 1990, responsible redevelopment officials realized that if they did not reduce this RDA "tax grab," the consequences for redevelopment could be dire. They joined in advocating legislation to curb cities and counties from declaring project areas so indiscriminately as to starve other taxing entities of future property tax receipts.

The redevelopment reform legislation known as Assembly Bill (AB) 1290 was passed in 1993. Borrowing a concept from the federal urban renewal legislation, the state legislature sought to define blight as an urbanized area with problems so substantial as to

¹⁰ This area was comprised of: Bunker Hill Redevelopment Project, 133 Acres; Central Business District Redevelopment Project, 537.9 Acres; Central Industrial Redevelopment Project, 738 Acres; Chinatown Redevelopment Project, 303 Acres; City Center Redevelopment Project, 879 Acres Council District 9 Corridors Disaster Recovery Project, 2,817 Acres; and Little Tokyo Redevelopment Project, 67 Acres. See Community Redevelopment Area/Los Angeles, Downtown Regional Area, http://www.crala.org/internet-site/projects/Regional_Areas/downtown_region.cfm.

¹¹ The reader is referred to our online appendix at <https://msbfile03.usc.edu/digitalmeasures/cswenson/intellcont/Appendix%20to%20Accompany%20Lefcoe%20Swenson-1.pdf> which shows detailed GIS maps of RDA areas in Northern and Southern California, as well as the Los Angeles Metro area.



seriously burden a community, both physically and economically, in a manner that was irreversible by private or government action without redevelopment. But RDAs found ways around it. The failure of AB 1290 failure was predictable and understandable:

State laws invariably delegate the task of making blight findings to the same local government sponsoring the TIF-funded redevelopment project. Some officials use their best efforts to comply, while others hire permissive consultants and rely on their findings uncritically. In any event, few blight determinations are ever challenged in court. Blight litigation is complicated and expensive. The attorneys most capable of filing such challenges are jeopardizing their future dealings with the city officials they sue and with officials in other cities who get wind of their whistle-blower-like behavior. Challengers usually lose when contending that a particular renewal area wasn't blighted; standards of judicial review strongly favor upholding local government decisions (Lefcoe, 2011, p. 446).

A few attorneys did file winning lawsuits challenging outrageous abuses of the new redevelopment strictures.¹² But this did not deter widespread flouting of the law. The mayor of a prosperous suburb, asked how he could possibly describe any part of his idyllic city as blighted,¹³ responded that he had to compete for property and sales tax revenues with neighboring towns no less affluent than his, and he was only doing what they had done earlier (Lefcoe, 2001).

Two years after the enactment of AB 1290, the Legislative Analyst's Office found no significant change reducing the size of project areas or any greater focus on the elimination of blight (Legislative Analysts Report, 1994).

I. From Negotiated to Legislated TIF Pass-Through Adjustments to Buffer the Losses of Other Taxing Entities

City RDAs managed to reach compromises with other taxing entities over the distribution of TIF money. These contracts were negotiated separately by RDAs with each affected taxing entity. But counties and some of the special districts proved far more adept at negotiating good deals than the typical school district.¹⁴ So in 1994 the state

¹² Lefcoe (2001) provides a discussion of the suits brought by Murray O. Kane.

¹³ In *Beach-Courchesne v. City of Diamond Bar*, 80 Cal. App. 4th 388 (2000), the appellate court found there was no support for the required finding of physical blight under any theory, and no basis for declaration of blight under California Health and Safety Code, and reversed with directions to invalidate the plan.

¹⁴ These entities sometimes threatened legal action when redevelopment plans were drawn that skirted formal legal requirements for "blight" and other statutory safeguards. They were also entitled to claim annual post-Proposition 13 inflation increases of up to 2 percent a year. By comparison, school districts were not very good at negotiating TIF rebates, and often neglected to make claims for the allowable inflation adjustments.

enacted a law barring one-on-one contracts between RDAs and other taxing entities. Instead, the state established mandatory pass-through payments that RDAs would be obligated to remit — a fixed rate of 20 percent of each of the other taxing entities' TIF contributions. Schools came out far better under this arrangement than they had in the “freedom of contract” days (Lefcoe, 2012).

J. Under Proposition 13, Redevelopment Projects Can Accelerate the Recognition of Increased Valuations Without Having Created Them

Another indirect and seldom mentioned impact of Proposition 13 is that it undermines the conventional justification for TIF. The case for TIF is that but for the changes that redevelopment brings about, there would be no increased property values in the project area.

Proposition 13 defers the recognition of increased property values, resulting in assessed values that tend to lag well below current market values. Redevelopment activity can spark recognition within designated project areas without actually increasing real values simply by encouraging changes in ownership or providing subsidies for new construction which would trigger huge re-assessments of already valuable vacant or underutilized properties.

III. THE CASE AGAINST DRAINING TAX INCREMENTS FROM TAXING AGENCIES OTHER THAN THE SPONSORING CITY OR COUNTY

The conventional rationale for TIF argues that schools, counties, and special districts will not lose any property tax revenue, as they continue to receive property taxes based on the assessed values of properties within their domains in the year before redevelopment. At the same time, when all RDA-issued debts are eventually repaid, the other taxing entities will start to receive the tax increment bonanza that redevelopment made possible.

These rationales are seriously flawed. First, they disregard the ex-ante risk-reward imbalance that cities sponsoring redevelopment impose on other taxing entities. Second, they presume that but for redevelopment there would have been no growth within designated redevelopment project areas. Third, redevelopment projects seldom create new demand. They simply shift demand from other areas into redevelopment project areas. The larger the boundary of the other taxing entity, the more likely it will be a net loser of property, sales, or hotel transit occupancy taxes due to redevelopment “cannibalization.” Fourth, nothing prevents cities from using TIF to subsidize local public goods like parks, libraries, and street and sidewalk improvements that were traditionally financed from local general funds, general obligation bonds, or special assessments. Fifth, TIF encourages RDAs to subsidize projects that will yield higher property taxes such as high rise, glass curtain wall condos, or greater sales tax proceeds, such as auto malls and regional shopping centers, while neglecting the cost of displacing lower and working class populations.

A. The Risk-Reward Imbalance of TIF-Funded Redevelopment for Other Taxing Entities

There is a striking asymmetry in the risk-reward trade-off for other taxing entities in a TIF-funded redevelopment project. If the project is a staggering financial failure, it could even push property tax revenues below pre-redevelopment levels — a burden that will be borne by the other taxing agencies.¹⁵

If the redevelopment project proves to be an enormous financial success, the other taxing entities will see little of the bonanza until all the redevelopment debt is fully repaid. To defer termination, RDAs and their sponsoring cities repeatedly extend and amend redevelopment plans.¹⁶

This imbalance is exacerbated because decision-making is vested solely and exclusively in the RDA and its sponsoring city or county. The other taxing agencies have no right to decide whether they want to participate in a proposed redevelopment project.

B. RDAs Include Growth That Would Have Occurred Without Them in Calculating Tax Increments

Buoyant growth throughout the state enabled redevelopment projects to prosper. Between the mid-1970s and the 1990s recession, “California’s economy generally outperformed the nation’s, often by considerable margins” (Legislative Analyst’s Office, 1995, p. 5). In the pre-Proposition 13 universe, school districts would have had access to the property tax revenues generated by the general increase in property values statewide:

A study by the California Redevelopment Association (CRA), typical of the poor quality of evaluation done by most economic development agencies, claimed that redevelopment had created 304,000 jobs statewide. California’s Legislative Analyst, answering the question “Should California End Redevelopment?” faulted the CRA’s study for failing to address this crucial question: but for the redevelopment agency’s efforts, would the project have been built anyway, either within the project area or elsewhere within the county or state? (Lefcoe, 2012, p. 779).

In contrast to the CRA study, two empirical studies have examined the economic impacts of the California RDA program in light of this “but for” issue. Dardia (1998) provided a detailed empirical evaluation of RDAs from 1993–1996. Examining 38 project areas in three counties (Los Angeles, San Mateo, and San Bernardino), he compared

¹⁵ Parker (2013) describes the disastrous Roanoke Rapids Theatre misadventure that ended up costing the city sales tax revenues and possibly a \$14 million capital loss.

¹⁶ For example, see *99 Cents Only Stores v. Lancaster Redevelopment Agency*, 237 F. Supp. 2d 1123 (C.D. Cal. 2001). The RDA began a “power center” project in 1988, completed it in 1991, and then amended the plan several times, including in 1997, without taking account of the changed blight standards that had been enacted by the state legislature in 1993.

actual property tax valuation changes for Census tracts that contained RDAs to matched tracts in the same cities that did not have RDAs. Two thirds grew more rapidly, but one third grew less. More importantly, he concluded that only four of the 38 project areas grew fast enough to be considered self-financing.

Swenson (2014) examined the impact of California RDA policies on RDAs at the census tract level, digitizing individual RDA maps to create precise areas of RDAs and also of their adjoining Census tracts. Using related economic data from the Census for 1980, 1990, and 2000 to compare the economic performance of RDAs to immediately adjacent areas, as well as to the rest of California, he found that in the 1990s RDAs had little measurable impact on RDA area employment, poverty rates, family incomes, rental vacancy rates, and average residential rental rates. He also found that there was little measurable business growth in such areas during the 2000–2009 decade in terms of job creation or business revenues.

C. Cannibalization

Cannibalization is a marketing term that refers to competing products or firms draining market share from each other. New development increases the supply of space but does little to increase long-term aggregate demand for space, goods and services (Ingraham, Singer, and Thibodeau, 2005). The mantra “build it and they will come” rarely works, except to shift already existing demand from one location to another.

Inter-municipal competition based on tax breaks or infrastructure subsidies to attract new firms is short-sighted. Competing cities could easily be tempted to out-spend each other to attract retail outlets that yield disappointing sales and property tax results, engaging in a “race-to-the bottom” tax competition that significantly depletes their tax bases (Cassell and Turner, 2010).

For example, Frisco, Texas, a prosperous, fast growing suburban city, gave millions of dollars in tax incentives to attract an IKEA. Tax incentives don’t increase the regional demand for furniture; at most they just shift the location of furniture spending, or perhaps just the locations of showrooms where consumers look at furniture before buying it online. Why do officials in places like Frisco, Texas, assume that adjoining cities, in this case, Dallas, will not eventually offer an even more attractive subsidy or incentive for an IKEA rival? While state legislatures are in a position to end TIF-based bidding wars among localities for retail development, very few states have done so (Lefcoe, 2011).

Unless the boundaries of other taxing entities — such as schools, special districts or counties — are coterminous with the boundaries of the city sponsoring the redevelopment project, there could be net losses of property, sales or hotel occupancy taxes. Many California counties¹⁷ vigorously opposed city-sponsored redevelopment because they

¹⁷ Counties have multiple roles in California. Since they are the administrative arm of the state, they are responsible for public assistance, public protection, and health. Counties are also responsible for delivering local services and providing local facilities to their unincorporated communities, including law enforcement, waste collection, and roads and parks. At times, counties contract with cities or other public, non-profit, or private agencies to provide some of these services. Counties also perform countywide activities such as assessing and collecting property taxes and operating jails.

recognized that most if not all of the TIF-absorbing development would occur anyway somewhere within the county. This is not only true of retail. Returning to the Bunker Hill example, most of the downtown Los Angeles office tenants would have located somewhere within Los Angeles County.

Similarly, when the other taxing entity is the state government itself, the chances are even smaller that a particular TIF-funded redevelopment project would have left California “but for” that city’s redevelopment efforts. This is another reason why the state of California could be understandably more wary than a county, a special district, or a school district of the net tax impacts of TIF-funded redevelopment on its revenues.

D. Strategies for Using TIF to Fund Local Public Amenities That Do Not Increase Property Values

A city anticipating ever-rising property values can use TIF to finance traditional local public goods instead of drawing on the sponsoring city’s or county’s general funds, general obligation bonds, or special assessment revenues. Typical public goods would include parks, libraries, parking structures, and street and sidewalk landscaping improvements. This is unfair to county taxpayers who reside far from the TIF-exploiting city and hence will never use the public amenities their tax dollars inadvertently helped to finance. This practice also betrays the central promise inherent in redevelopment of stimulating new private development that will generate tax increments. Because public goods like parks and libraries are tax-exempt, such amenities are not likely to result in valuation dividends sufficient to compensate for the TIF foregone by other taxing entities.

E. TIF-Based Redevelopment Is Structurally Unsited to Assisting Low and Moderate Income Residents

Redevelopment of blighted areas already ripe for gentrification produces large property tax increments (Lefcoe, 2008). Programs meant to encourage new development in low income neighborhoods without destroying them need to be funded in ways other than, or in addition to, TIF.¹⁸ A good example of this can be found in the New Markets Tax Credit (NMTC). Although it has attained mixed results so far, its generous tax credits are intended to spur equity investment in low-income neighborhoods (Theodos, 2013). Eligibility is determined by federal guidelines that define low-income areas, not by local governments or their private partners seeking tax credits. Rittenberg (2011, p. 13) notes, “The NMTC Program attracts investment capital to low-income communities by permitting individual and corporate investors to receive a tax credit against their Federal

¹⁸ Rittenberg (2011, p. 13) also observes that, “TIF revenues can be put towards the relative public costs of infrastructure, while developer and tax credit equity can go into the bricks and mortar development to be located within the district. These two programs may work particularly well in states that strictly limit the use of TIF revenue to infrastructure costs alone.”

income tax return in exchange for making equity investments in specialized financial institutions called Community Development Entities (CDEs).¹⁹ Hence, investors can achieve acceptable rates of return without gentrification and the increased rents and sales prices it spurs.

IV. THE END GAME: ASSEMBLY BILLS ABX1 26 AND ABX1 27

A. The Prelude to ABX1 26 and ABX1 27

By the late 1990s, the state government was running recurrent annual deficits. Politically deadlocked, the legislature had difficulty raising the state taxes it needed to finance its mandated obligations for education. It was easier to marshal support to raid the revenue sources of local governments, including property taxes and vehicle license fees.²⁰ The state also re-directed billions in property tax revenues away from RDAs, mostly to fulfill the state's financial obligations for education.²¹ This infuriated local elected officials and RDAs.

In 2004, local governments succeeded in passing Initiative 1A to prevent further diversions to the state of local revenue sources.²² In 2010, to create parallel protection for RDAs, the League of Cities and the California Redevelopment Association supported a winning ballot initiative called Proposition 22.

Though pleased with their ballot box success, a close examination of the campaign for Proposition 22 reveals that its supporters were cognizant of the political vulnerability of redevelopment. They carefully avoided any mention of redevelopment in their

¹⁹ U.S. Department of the Treasury, "New Markets Tax Credit Program," http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5, reports that, "Since the NMTC Program's inception, the Community Development Financial Institutions Fund has made 749 awards allocating a total of \$36.5 billion in tax credit authority to CDEs through a competitive application process."

²⁰ The state of California has had unusually broad authority under the state constitution over local government finance (Lefcoe, 2012). This allowed auditors to shift the allocation of local property tax revenues from local government to "educational revenue augmentation funds (ERAFs), directing that specified amounts of city, county, and other local agency property taxes be deposited into these funds to support schools... Since their inception, the ERAF shifts have deprived local governments of nearly \$110 billion. Counties have borne some 73 percent of this shift; cities have shouldered 16 percent" (League of California Cities, "Fact Sheet: The ERAF Property Tax Shift," <http://www.californiacityfinance.com/ERAFfacts.pdf>).

²¹ See *Application for Leave to File Amicus Curiae Brief Pursuant to C.R.C. 8.25 (b) (3)*, and *Amicus Curiae Brief in Support of Respondents at 5 Cal. Redevelopment Ass'n v. Matosantos*, No. S194861, 267 P.3d 580 (Cal. 2010), <http://www.courts.ca.gov/documents/28-s194861-acb-municipal-officials-100411.pdf>.

²² The question on the ballot was: "Should local property tax and sales tax revenues remain with local government thereby safeguarding funding for public safety, health, libraries, parks, and other local services? Provisions can only be suspended if the Governor declares a fiscal necessity and two-thirds of the Legislature concur." It passed 83.7 percent to 16.3 percent. Proponents spent \$8.7 million, while opponents spent nothing ([http://ballotpedia.org/California_Proposition_1A,_Local_Property_and_Sales_Taxes_to_Remain_with_Local_Governments_\(2004\)](http://ballotpedia.org/California_Proposition_1A,_Local_Property_and_Sales_Taxes_to_Remain_with_Local_Governments_(2004))). See also Jean Ross, "The California Budget Project Budget Brief," <http://www.cbpp.org/pdfs/2004/0409prop1A.pdf>.

ballot arguments and called it “The Local Taxpayer, Public Safety, and Transportation Protection Act of 2010.”

As the brief supporting the respondents cited above pointed out, the ballot arguments in its favor addressed transportation funding. Only the opponents, led by the California Teachers Association, explicitly drew the connection between the initiative and redevelopment.²³ Earlier, the proponents of Proposition 1A had deliberately excluded any mention of redevelopment, fearing it would be a political liability.

Once Proposition 22 passed, in 2012–2013 the state government was constitutionally precluded from removing funds from RDAs as it had done nine times from 1992–2011 (Legislative Analyst’s Office, 2012). This left the permanent dissolution of redevelopment as the state’s only remaining option for re-directing property taxes away from RDAs to more urgent public needs.

B. ABX1 26 and ABX1 27 in a Nutshell

The state legislature dissolved RDAs through a series of amendments to the California Health and Safety Code in legislation known as ABX1 26 (also known simply as AB 26). To secure the support of some lawmakers friendly to redevelopment, the legislature offered a “pay-to-stay” option. For a steep price, dissolution was avoidable under a companion statute ABX1 27, also known simply as AB 27.

Cities could obtain their AB 27 funds from any source they chose, including transfer payments of TIF from their RDAs. Cities had to notify the County Auditor, the State Comptroller, and the State Department of Finance before November 1, 2011 that they intended to comply. In order to facilitate timely compliance, some city councils drafted ordinances pursuant to AB 27. The draft prepared by the city of San Diego reserved all of its rights to challenge the legality of AB 26 and 27 and specified that no general fund revenues would be allocated to make the payments required under AB 27.²⁴

C. How Redevelopment Tax Increment Funds Are Being Re-Distributed Following Dissolution: AB 26 in Practice

The fiscal purpose for dissolving RDAs was to re-direct tax increment funds from redevelopment to counties, education and special districts.²⁵ The re-distribution process has been delegated to county auditor-controllers.

²³ The California Teachers Association argued the proposition would “give money to redevelopment agencies at the expense of the state budget and the core services that are supported by the state budget, such as public education” (http://ballotpedia.org/California_Proposition_22,_Ban_on_State_Borrowing_from_Local_Governments). The proposition passed 60.7 percent to 39.3 percent, with proponents spent \$5.8 million and opponents spending \$1.8 million.

²⁴ The draft of the ordinance is available at <http://dockets.sandiego.gov/sirepub/cache/2/m0kjrtzoh0xuzut01wsa0bhl/35594704072014030537137.PDF>.

²⁵ The information in this sub-section is based on a phone conversation between the authors and Los Angeles County Acting Auditor-Controller, John Naimo, on April 18, 2014, as edited and modified by Arlene M. Barrera, Assistant Auditor-Controller, Los Angeles County.

Redevelopment agency obligations have been assumed by successor agencies, which are now responsible for reporting to the county auditor-controller and the State Department of Finance (DOF) on all the enforceable obligations of the RDAs they have replaced. Successor agencies present these claims every six months in advance for DOF review. The DOF notifies the county auditor-controllers of approved enforceable obligations, and the maximum amount of funds to remit to each successor agency.

The Los Angeles County auditor-controller continues to collect tax increment funds for the 71 former RDAs in the county, just as it did before the dissolution. But instead of distributing these funds directly to the successor agencies, the auditor-controller has established Redevelopment Property Tax Trust Funds (RPTTFs) for each of the 71 former RDAs.

From each of these funds, the auditor-controller is mandated by state law to make distributions in the following order:

(1) *Administrative Cost Reimbursement.* The auditor is entitled to reimbursement for its costs. In Los Angeles County there are 20 full-time employees working on post-redevelopment accounting. As a percentage of the total TIF the county receives each year, the administrative cost is a fraction of 1 percent. This cost is levied against each of the 71 RPTTFs as a percentage of its total assets. Presumably, the bigger the former RDA and the larger the sums in its RPTTF, the more time the county staff will have to dedicate to analyzing its claims and payments.

(2) *Pass-throughs to Other Taxing Entities.* RDAs had been obligated to make certain pass-through payments to the various taxing entities from which sponsoring cities or counties had received tax increments. Before 1994, those payments were negotiated. For instance, a sponsoring city could have entered separate contracts to rebate various sums of money to the county, fire and other local special districts, and school districts. Contracts entered before January 1, 1994, continue to be honored. These pass-through contracts vary enormously not only in the amounts rebated but also in payment priorities. In some cases, the other taxing entity had agreed to subordinate its future pass-through payments to other agency debts including bonds and contract obligations.

As discussed above, some entities struck better deals than others and school districts in particular were rarely astute negotiators. In response, the legislature decided that for new RDA project areas formed after 1994, each taxing entity would be entitled to receive a payment equal to 20 percent of its total TIF contributions to that RDA. When redevelopment projects were amended, a taxing entity would be ineligible for the 20 percent on amounts they had been contributing before January 1, 1994. But they would be entitled to a 20 percent pass-through payment on contributions above their 1994 levels. For example, suppose a county had been contributing \$200,000 a year to a city-sponsored RDA project formed in 1990. In 2003 the city amended the project. At that point the county's annual TIF contribution increased to \$220,000. The county would be entitled to an annual pass-through payment of 20 percent of \$20,000 — \$4,000 per year. Post-dissolution, the county-auditor would be obligated to continue to make the \$4,000 payment from that particular successor agency's share of the RPTTF.

(3) *Enforceable Obligations.* Next in order of priority are the “enforceable obligations” of the various RDA successor agencies. Every six months the successor agency presents the county auditor-controller with a list of payments coming due in the next six-month period.

Repayment of bonded indebtedness comes first. Bond payments are readily calculable. A more challenging set of “enforceable obligations” arose from contracts to facilitate redevelopment projects that RDAs had entered with private redevelopers including owner-participants, and with other entities private and public. Many cities entered agreements with their own RDAs on the eve of dissolution to transfer RDA assets to the city so they would not be subject to forced sales for the benefit of all former TIF-paying entities. These agreements are being challenged by the state DOF or counties. The successor agency must meet and confer with the DOF before litigating enforceable obligation claims denied. The number of denials and disputes is falling quickly as DOF articulates the basis for its outcomes, and successor agencies become familiar with the difference between acceptable and unacceptable claims.

(4) *Successor Agency Administrative Costs.* The final draw against RPTTF funds is the administrative cost that each successor agency incurs — but only to the extent that there is money remaining in that agency’s particular RPTTF. Some cities heavily burdened with redevelopment debt have no money left in their account, leaving the sponsoring city or county to pay or suffer the consequences of not being able to recoup money to cover enforceable obligations.

(5) *Distributions to Each Taxing Entity.* Lastly, each of the taxing entities receives a share of the residual based on the percentage of the property tax that it is entitled to receive under state law. The percentages vary greatly among taxing agencies because, as described above, they are based on how the state allocated property taxes to local governments after the enactment of Proposition 13.

Before distributing the residual left in each RPTTD, the county auditor-controller is required to rebate the pre-1994 contracted pass-through payments to each taxing agency entitled to them. Some taxing agencies that had struck particularly favorable arrangements may be subject to a statutory “haircut” designed to make sure they are not receiving more than their fair share of the distributed residual.

(6) *The Look Back “True Up.”* The county auditor-controller looks back each six months to ascertain that successor agencies actually spent the money they claimed was due on enforceable obligations. This is known as a “true up.” The auditor-controller simply offsets unpaid amounts against future remittances to the successor agency.

Part of the dissolution process involved successor agencies turning over excess assets to the county auditor-controllers. Some excess assets consisted of real property acquired for redevelopment projects that have now been terminated. These assets are to be sold, assuming they are not suitable and claimed for a public or government related use. To this point, sales of realty assets have been minimal.

A more immediate source of revenue was the cash being kept in RDA reserve accounts to cover future obligations. Because the dissolution process contemplates honoring

all prior RDA obligations, these reserves are no longer needed and will be swept into various RPTTFs.

Although eventually \$5 billion a year could flow from RDAs to cities, counties, schools and special districts, in the first year post-dissolution the state received less than \$1 billion. The \$5 billion figure was a rough estimate looking decades forward to the time when all redevelopment agency indebtedness would finally have been repaid, all excess RDA assets sold, all other unenforceable RDA obligations satisfied, and all pass-through payments and administrative costs no longer being incurred. In the next few years, the \$1 billion level is a more realistic estimate of what the state is likely to receive from RDA dissolution.

D. AB 27: Fact, Fiction, and Inscrutability

When the legislature enacted AB 27, the “pay-to-stay” option, advocates claimed that if all RDA-sponsoring cities and counties participated, the provision would yield \$1.7 billion for schools and \$400,000 for special districts in its first year. These numbers were as fanciful as the \$5 billion tag placed on RDA revenues.

AB 27 was not just a one-year statute. In the second year, the education “take” would have dropped. The state wanted at least \$400 million, adjusted annually, plus an amount equal to 80 percent of the school district’s share of new debt service incurred by a redevelopment agency after November 1, 2011.²⁶ The statute is unclear (Weston, 2012), and the Legislature noted that subsequent clarifying legislation might be needed.

V. LITIGATION CHALLENGING AB 26 AND AB 27: CRA V. MATOSANTOS

The constitutional challenge to AB 26 and 27 rested entirely upon two provisions in the California constitution, the only ones that were even remotely relevant. Unlike the federal government, states are not a federation of otherwise independent entities. Cities, counties, special districts, and school districts are regarded as creations of the state. A bedrock principle of state constitutional law is that state governments possess absolute discretion to create and dissolve local governments,²⁷ subject only to explicit limitations in the state constitution.²⁸ It takes a very explicit state constitutional excep-

²⁶ This information was provided in an email to George Lefcoe from Iris Yang, Best, Best, and Krieger, dated April 15, 2014.

²⁷ “The number, nature and duration of the powers conferred upon these [municipal] corporations and the territory over which they shall be exercised rests in the absolute discretion of the State ... The State, therefore, at its pleasure may modify or withdraw all such powers ... extend or contract the territorial area, unite the whole or a part of it with another municipality, [or] repeal the charter and destroy the corporation.” (*Matosantos*, 267 P.3d at 597, quoting *Hunter v. Pittsburgh*, 207 U.S. 161, 178–179 (1907)).

²⁸ For instance, county boundaries may not be changed by the Legislature without an election in the affected county. On the other hand, cities “are mere creatures of the state and exist only at the state’s sufferance.” (*Board of Supervisors of Sacramento County v. Local Agency Formation Common*, <http://www.courts.ca.gov/documents/3-s194861-resp-matosantos-and-chiang-informal-opp-to-pfwof-07-27-11.pdf>).

tion to empower a court to deny the state plenary control over local government entities, including RDAs.

Nor do entities like cities, counties, special districts, or RDAs have any U.S. constitutional right to exist. The U.S. Constitution only protects the existence of states and offers no safeguards against the unfettered discretion of state governments to create, modify, or abolish cities, RDAs or other local government entities. They are all subordinate to the state and beholden to it for their existence.

The only federal constitutional provision that could come into play was Article 1, Section 10, Clause 1: “No state ... shall pass any Law ... impairing the obligation of contract.” This provision prevents states from dishonoring private contracts that cities, counties, or RDAs had entered before dissolution. Hence, as a matter of federal constitutional law, to the extent that redevelopment funds had been pledged through private contracts, the state would have to institute a mechanism for honoring them even after it cut off access to the funds, post-dissolution.

The California Redevelopment Association and the League of California Cities based their challenge of AB 26 and AB 27 on two state constitutional provisions. The first was California Constitution, Article XVI, Section 16. The plaintiffs contended that the legislature could not dissolve the agencies that they had created pursuant to this constitutional amendment. But they realized this was a weak argument because the constitutional provision itself did not even require the legislature to establish RDAs in the first place.²⁹ The provision began with the words: “The Legislature MAY provide ... and the redevelopment plan MAY contain a [provision for TIF]” (emphasis added).

The only serious constitutional impediment to AB 26 was Proposition 22, which prohibits the state from requiring “a community redevelopment agency (A) to pay, remit, loan, or otherwise transfer, directly or indirectly, taxes on ad valorem real property and tangible personal property allocated to the agency pursuant to Section 16 of Article XVI to or for the benefit of the State, any agency of the State, or any jurisdiction.”

Basically, the plaintiffs were contending that the only reason the state had sought to abolish redevelopment was to capture redevelopment agency property tax revenues. They argue that anyone who had been paying the slightest attention to the political realities of the day would realize that AB 26 and 27 had only one purpose — an end-run around Proposition 22.

This argument was unconvincing, as there is a long-standing norm that courts do not inquire into legislative motives, and the legislature had many other reasons to abolish redevelopment. RDAs had flouted state laws attempting to confine redevelopment to blighted areas, and used eminent domain in controversial ways (Lefcoe, 2010). The Proposition 22 argument was that the AB 27 payments required of cities or counties could be drawn from RDA TIF coffers, contrary to Proposition 22.

²⁹ The California Constitution, Article XVI, Section 16, states that, “The Legislature may provide that any redevelopment plan may contain a provision that the taxes, if any, so levied upon the taxable property in a redevelopment project each year by or for the benefit of the State of California, any city, county, city and county, district, or other public corporation (hereinafter sometimes called “taxing agencies”) after the effective date of the ordinance approving the redevelopment plan, shall be divided as follows ...”

Faced with these constitutional challenges, the California Supreme Court had four options: (1) declare both AB 26 and AB 27 unconstitutional, leaving RDAs intact and banning further fund diversions from TIFs; (2) declare both constitutional, leaving RDAs in place but subjecting them to over \$2 billion in transfer payments to schools and special districts; (3) invalidate the dissolution provisions leaving RDAs intact, and validate the “pay-to-stay” legislation, leaving RDAs vulnerable to this and future legislated diversions of TIF funds to schools and special districts; or (4) validate the dissolution provisions, and invalidate the “pay-to-stay” laws, putting RDAs out of business.

The state defended both AB 26 and AB 27 as constitutional, supporting option (2). Santa Clara County in an amicus curiae brief argued the case for option (4), as it had long opposed the RDA of the City of San Jose for siphoning significant TIF money from the county.³⁰

A few counties had their own RDAs and opposed AB 26. But most counties had little affection for AB 26 or AB 27. Many county officials perceived RDAs as having plundered property taxes that should have gone to the counties. Moreover, many counties had been left out of AB 27 while providing generously for schools and special districts.

The California Redevelopment Association (CRA), representing city and county RDAs, contended that both AB 26 and AB 27 were unconstitutional. According to lawyers advising the CRA, redevelopment officials never seriously considered defending the validity of AB 27. As puzzling as this might seem, it was understandable both in terms of appellate strategy and practical outcomes. Proposition 22 was the only viable basis for assailing the constitutionality of AB 26. In candid moments, no well-versed California redevelopment attorney could doubt that the original redevelopment legislation was anything but an enabling law.³¹ The League of California Cities and the Community Redevelopment Agency made this clear by inference in explaining the basis of their constitutional challenge to their constituents.³² The gist of their argument was that AB 26 was simply a circuitous way to extract TIF revenue from RDAs, contrary to Proposition 22.

How could the California Supreme Court have ignored this essential political truth? Easily. The Legislature had made AB 26 severable from AB 27. Even if the Court invalidated AB 27, AB 26 would stand on its own constitutional footing. No one seriously doubted the right of the State to abolish any and all local government entities at will.

In addition, Proposition 22 had not explicitly enshrined redevelopment as perpetual and inviolable; rather, it was designed to keep the state from raiding RDA TIF funds

³⁰ California counties were deeply divided on redevelopment. Having formed redevelopment projects in unincorporated areas, Riverside and San Bernardino counties saw redevelopment as an essential tool for combating blight. “Santa Clara County[,] ... the most vocal in supporting the ruling[,] ... forcefully argued before the court that the agencies should be dissolved. In Santa Clara County, most development happened in cities, such as San Jose. Jean Kinney Hurst, legislative representative for the California State Association of Counties, said the group’s members are all over the map” (Taggart, 2012, p.1).

³¹ This point is discussed further by Lefcoe (2012).

³² See California Redevelopment Association, “Summary of CRA/League Lawsuit Regarding AB1X 26 and 27,” <http://www.calredevelop.org/external/wcpages/wcwebcontent/webcontentpage.aspx?contentid=438>.

as long as they were in existence. When the authors crafted Proposition 22, they never considered the possibility that the Legislature would abolish redevelopment. In the words of the Court: “Proposition 22 is best read to limit the Legislature’s powers over RDAs while they are in operation, not while the Legislature seeks to dissolve them altogether.”³³

Having taken that surprising step, to “read between the lines” and interpret Proposition 22 as inapplicable to AB 26, why could the Court not have done the same to save AB 27 from invalidation under Proposition 22? Both AB 26 and AB 27 “contained previously unimagined dissolution scenarios. The asymmetry is puzzling since both statutes are, essentially, about redevelopment fund transfers, incident to dissolution or its avoidance” (Lefcoe, 2012, p. 794). Surely, voters who wanted to protect redevelopment funds from the state would not have intended Proposition 22 to invalidate the opportunity that AB 27 provided to save those agencies from dissolution. Indeed, the Chief Justice, dissenting, made this argument.³⁴

The attorneys representing the state were arguing to uphold both Legislative enactments, one of which was meant to preserve RDAs:

The Legislature could have stopped after dissolving RDAs. Taking the additional step of offering a new, voluntary program merely provides an opportunity for those cities and counties that want to pursue redevelopment to do so, albeit on a different financial footing reflecting current fiscal realities.³⁵

The position of the League of California Cities and the California Redevelopment Association (CRA) was that cities and counties would have no choice but to pay to stay, even though they knew from survey results among their members that one-third or more of the 427 RDAs would close because they could not afford to make “ransom payments.”³⁶ They characterized AB 27 as theft,³⁷ and were determined to invalidate AB 27

³³ See Maroon (2013) and *CRA v. Matosantos*, 53 Cal. 4th 231, 263 (2011).

³⁴ Lefcoe (2012, p. 794) observes that, “The irony was not lost on the Chief Justice of the Court interpreting ‘the very measure that was crafted to protect financing for new redevelopment projects ... in a manner that effectively ends all financing for new redevelopment projects. This cannot be a necessary result intended by the proponents of Proposition 22 concerning redevelopment.’”

³⁵ *Informal Opposition to Petition for Writ of Mandate; Request for Issuance of Alternate Writ and for Order Expediting Briefing, Case No. S194861*, in the Supreme Court of California, *CRA v. Matosantos*, (2011).

³⁶ This characterization appears in a memo from League of California Cities executive director Chris McKenzie to California City Officials, “Background on *CRA et al. v. Matosantos*,” dated January 5, 2012, and cited in Lefcoe (2012, p. 795).

³⁷ “CRA and the League contend in *CRA v. Matosantos* that AB 1X 26 and 27 are unconstitutional because they violate Proposition 22, which was passed by the voters in November, 2010. Proposition 22 prohibits the State from transferring redevelopment funds. Both the State and the County assert that this prohibition does not apply if redevelopment agencies are dissolved. As the reply brief states, this reasoning suggests the State and the County ‘believe that Proposition 22 is like a hypothetical robbery statute that prohibits the theft of someone’s money unless the victim is killed first.’” California Redevelopment Association, “CRA and League File Their Reply to the State and Santa Clara County Defense of AB 1X 26 & 27,” <http://www.calredevelop.org/External/WCPages/WCWebContent/WebContentPage.aspx?ContentID=1624>.

because if it survived a Proposition 22 challenge, it would set a precedent in favor of future state efforts to capture TIF revenues, which they anticipated would occur.

VI. OPTIONS FOR CITIES AND COUNTIES TO ACHIEVE REDEVELOPMENT GOALS IN OTHER WAYS

This brings us to a final question: why did RDA-sponsoring cities and counties abandon redevelopment when confined to spending only their own share of tax increment revenues? Even if they rejected the terms of AB 27, after *CRA v. Matosantos*, they could have sought legislation to re-constitute redevelopment but without the benefit of other entities' TIF.

Cities and counties are uninterested in reviving state redevelopment without TIF because, if they are limited to using their own revenues, they can achieve the same public or economic development purposes, free of the considerable constraints and costs imposed by redevelopment law compliance. For example, state redevelopment law imposes upon sponsoring cities and counties a requirement to set aside 20 percent of their TIF for affordable housing. In addition to this cost, new project areas would need to be declared "blighted," and to document findings of blight, would require reports prepared by costly consultants. Cities and counties bear no such burdens using their own tax revenues in contracts with private developers through development agreements,³⁸ public-private partnerships (Meyer, 2012), tax reimbursement contracts,³⁹ infrastructure privatization agreements (Dannin, 2011), leases (Tomaszczuk and Herzfeld, 2001), and other arrangements (Kosmont, 2014).

One advantage of the state redevelopment law was that it freed TIF-funded Tax Allocation Bonds from the state constitutional requirement of voter approval as a precondition to long-term debt. With proper drafting advice, a variety of arrangements are available to finance long term debt free of voter approval, including lease revenue bonds, industrial revenue bonds, infrastructure financing districts (IFDs), and parking authority privatization contracts.⁴⁰

³⁸ See Institute for Local Government, "Development Agreement Manual: Collaboration in Pursuit of Community Interests," http://www.ca-ilg.org/sites/main/files/file-attachments/resources_FinalDevAgreement4-5-02.pdf

³⁹ For example, in *Turken v. Gordon*, 220 Ariz. 456 the Arizona Court of Appeals upheld a city agreement to reimburse taxes to a retail developer against a challenge that the agreement was a violation of the Arizona Constitution Gift Clause. The court had no difficulty identifying the public benefit to the City: "[t]he City made this commitment to induce the Developer to build the development on a schedule and at a level that is more advantageous to the City than some other, differently configured project. By doing so, the City hoped to create a revenue stream for City North that would assure that the project included a large retail component so that the City could capture and maximize retail sales tax revenues."

⁴⁰ The California Debt and Investment Advisory Commission notes "Generally, the California Constitution requires voter approval for issuance of long-term debt paid from the general fund of a city, county, school district, or the state . . . [Avoidance] of classification as "debt" for purposes of the constitution . . . can be done in several ways using judicially created exceptions to the constitutional debt limit. . . . A long-term lease containing an obligation to pay fair-market rental in each year in which beneficial use and occupancy is tendered to the public agency — a long-term lease — is outside the constitutional debt limit." See California Debt and Investment Advisory Commission, *California Debt Issuance Primer*, <http://www.treasurer.ca.gov/cdiac/debtpubs/primer.pdf>.

Eminent domain would not be as widely available as it was under redevelopment,⁴¹ but the use of eminent domain for redevelopment was one of the main reasons it was deeply unpopular. Local governments were loath to use eminent domain and those that did often paid premiums to quiet recalcitrant property owners (Lefcoe, 2010). Local governments seldom prevailed when owners contested agency offers in jury trials. In practice, nimble developers often assemble land at better prices than public entities that cannot conceal their ambitious area-wide plans from public view long before starting to acquire property for public use.

One example of how a local government can pledge future sales tax increments to subsidize a much needed shopping center comes from South Gate, a high-density, moderate-income city outside of Los Angeles. South Gate has very little local retail, and residents drive long distances beyond its boundaries to shop, creating “leakage” in South Gate’s sales tax revenues per capita. The state sales tax is 7.25 percent. Since the state remits 1 percent of every taxed sale to the city or county where the sale originated, other cities were benefiting from sales to South Gate residents.

South Gate made a deal with Primestor, a private mall developer that specializes in bringing a careful mix of premier national tenants and local businesses to underserved minority communities. Primestor centers serve as “main streets” for staging public events to strengthen neighborhood camaraderie. The city agreed to sell Primestor a 32-acre vacant industrial site for a high quality 372,000 square foot regional mall. To fund indispensable off-site infrastructure improvements, the City of South Gate entered an Infrastructure Financing Agreement with the developer, with the improvements financed with a share of the future sales tax increments that the Primestor project generated.

Another source of revenue for public-private partnerships is the transit occupancy taxes (TOTs) levied on hotels. Local governments often enter agreements with hotel developers to rebate some or all of TOTs. Rebates can be structured in the same way that TIF residuals had been made available to other taxing entities at the end of a designated period of years.⁴²

Anticipating an increase in the use of public-private partnerships, the state legislature has sought to make transparent the costs and benefits of such arrangements. The law requires all cities and counties to provide a detailed report to the public and a notice and hearing before approving any economic development subsidy of \$100,000 or more to corporations and other business entities. In addition, each city and county will need to review, hold hearings, and report on those subsidies at five-year intervals.

⁴¹ California Government Code Section 52200, subsection (c) affirms the need for cities and counties to continue certain powers afforded to redevelopment agencies that were critical to economic development yet do not have an impact on schools and the state budget. Government Code Section 52200.6 makes clear that economic development does not justify the use of eminent domain.

⁴² Kanzler (2013) reports that, “Anaheim City Council recently voted to help two, four-star GardenWalk hotels in its Resort District build, improve and create more than 3,000 new jobs by rebating back to those hotels, for a period of time, some of those taxes they pay, in order to help them secure financing for the project and to pay off the debt that helped beautify the Resort District in the 1990s. After 15 years, those rebates expire and the city would receive 100 percent of the TOT in perpetuity.”

A. Infrastructure Financing Districts

In the budget for the current year, Governor Brown is proposing to amend an existing law to make it easier for voters to implement infrastructure financing districts (IFDs). These are similar to redevelopment in that they allow local governments to fund public infrastructure through TIF. They are seldom used because of voter approval requirements.

The governor proposes to reduce the law's present two-thirds required majority to 55 percent and to "expand the kinds of projects created by the districts to include urban infill, affordable housing, transit priority projects, military base reuse, and other kinds of consumer services that the administration has not yet defined" (Young, 2014, p. 1).

Under the Governor's proposal, the sponsoring city is barred from tapping into any of the property taxes that would fund education. Further, local government entities would have to approve any project for which its share of the tax increment was being used (Young, 2014).

VII. CONCLUSIONS

The demise of TIF in California is a cautionary tale about property tax revenues, not necessarily a rejection of all redevelopment efforts. For reasons unique to California's property tax regime, many cities (and a few counties) used TIF-funded redevelopment so aggressively that they diverted significant property tax revenues from other taxing entities, and particularly from the State, which bears ultimate responsibility for financing public education.

When RDAs took to the ballot box to prevent the state from re-capturing those revenues, Governor Brown said "enough" and dissolved them. RDAs were drawing funds from other taxing agencies without their consent in order to subsidize sales tax-generators like shopping centers and auto malls, and TOT-generators like hotels. At first it may seem odd that sponsoring cities and counties had no interest in preserving their 427 RDAs unless they could retain the tax increments from other taxing entities; however, the explanation is simple. Any California city or county has virtually limitless ways to achieve the objectives once accomplished through redevelopment if it is only spending its own tax revenues. Cities and counties can enter these arrangements free of the costs and constraints of redevelopment law that had been imposed mostly to curb the use of other taxing entities' shares of the tax increment, a *raison d'être* now as much a matter of history as California redevelopment itself.

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