



CALIFORNIA REDEVELOPMENT AGENCIES – POLICY AND FISCAL REFORMS

California’s redevelopment agencies (RDAs) can transform local communities where decay, destruction, and hopelessness reside. Some of their efforts to eradicate blight have produced fine examples of urban renewal, economic development, infrastructure enhancement, and city beautification. But not all redevelopment agencies are following the goals and guidelines that the State has provided them. In fact, some have veered off course from their mission, and end up wasting the precious state and local funds that are needed to reinvigorate local communities.

For some agencies, excess spending on administration (with no *actual* blight abatement or housing creation) is the problem. In other areas, RDAs are formed to duplicate and compete with existing private services rather than eradicating *real* blight. In other cases, multiple and repeated condemnation of the *same* structures every few years diverts money from combating existing blight. Finally, some agencies *reduce* the number of low- and moderate-income housing options and never *replace* them. In all of these instances, and other cases of abuses, state taxpayers and local agencies foot the bill and all taxpayers and residents lose.

This paper will examine the origin of RDAs, their goals, tools, and original legislative intent. It will then discuss how RDAs are funded and by whom. The paper will then expose some disturbing RDA abuses, and millions of dollars in questionable state subsidies. Finally, the paper will make some suggestions for reforming RDAs and recapturing scarce state and local resources for worthier outcomes.

RDAs and their Mission of Eliminating Blight. More than a half-century ago, the state authorized redevelopment agencies (RDAs) to combat urban blight. RDAs are state agencies, but cities and counties activate them and form project areas to eradicate blight by acquiring, clearing, assembling, and improving land for development. In the 1950s, voters amended the California Constitution to give RDAs 100 percent of the property tax growth inside the special RDA project areas, otherwise known as “property tax increment,” to assist RDAs with their blight abatement projects.

Over the last six decades, the state has refined and limited the definition of “blight.” Today, the concept of blight is limited to a specific set of physical and economic conditions in predominantly urbanized areas. Where these conditions are serious, threaten the public’s health and welfare, and can’t be remedied by private enterprise, cities and counties activate their RDAs and form project areas to abate the blight. RDAs use property tax increment financing, along with the power of eminent domain, to abate

blight. In the 1970s, the Legislature expanded RDA's responsibilities to include the creation low- and moderate-income housing.

The Legislature has never intended for RDAs to serve as public property development companies, developing property just for sake of development or for the purpose of generating revenues for the sponsoring city. Elimination of blight in a specific area has always been the primary goal. In fact, once the blight eliminating objectives of the project have been met, the law provides for the closure of the RDA.

Funding RDAs and Financing RDA Projects. As described above, property tax increment revenue is the primary source of revenue for RDAs. The normal allocation formulas are set aside and property tax revenues are to be *temporarily* diverted from cities, counties, special districts and even school districts to combat blight. Once the blighted areas are redeveloped, normal property tax allocation is returned.

In areas without RDAs, property tax revenues are allocated to all the public agencies that provide services there, such as the county, the city, school districts, and water, fire, or other special districts. The three main sources for property tax growth are through new construction, changes in property ownership, and the annual two percent property tax growth allowed by law. Each year, as property tax revenues grow, the increased amount is allocated proportionately to these agencies. For example, in an area where there is \$100,000 of property tax revenues, schools may get 52% (\$52,000), the city 11% (\$11,000), the county 19% (\$19,000), and special districts 18% (\$18,000). If property tax revenues grow the next year by 10% to \$110,000, then each agency will get its original (base year) allocation, plus its proportionate percentage of the growth. In this case, schools would receive \$57,200, the city \$12,100, the county \$20,900, and special districts \$19,800. In future years, these allocations would continue growing to reflect their base year and annual property tax revenues increases.

When a city or county activates its RDA and forms a project area, it freezes the allocation of property tax revenues to local agencies. While the public agencies continue to receive the amount of property tax revenues they received in the RDA's base year, the RDA gets to keep any and all yearly increases in property tax revenues. In our example, after local property tax revenues had growth from \$100,000 to \$110,000, city, county, school and special district allocations would remain flat, and the RDA would receive 100 percent of the additional \$10,000. RDAs take the yearly increase in property tax revenues – the annual property tax increment – away from other local agencies in order to fund RDA projects.

Many RDAs use their authority to issue long-term bonds to finance projects in the area. Many of the bonds are backed by the property tax increment revenue stream and mature as many as 30 years later. In 2002-03, RDAs unmatured, year-end debt was \$19.7 billion, with tax allocation bonds representing \$11.5 billion of this amount. These bonds finance a variety of housing and infrastructure projects as well as other long-term improvements in the project areas.

Revenue to RDAs Means Loss of State General Fund Dollars. In 2002, RDAs statewide collected \$2.5 billion in tax increment. In fact, \$15 out of every \$100 of property tax revenue – 15% of the assessed value of all the property in the state – is

located within a redevelopment project area. Absent RDA activity, revenues from these areas would have funded cities, counties, special districts, and most of all, schools.

When RDAs divert property tax revenues from other local agencies, school dollars take the biggest hit. Statewide, an average of 52% of each property tax dollar flows to schools; in some areas, schools receive up to 76% of all property tax revenues. But schools don't pay the price for local redevelopment, state taxpayers do.

Due to school financing laws that voters approved with the passage of Proposition 98, the State General Fund must backfill any local property tax losses to schools. Because redevelopment diverts \$2.5 billion annually in tax increment from schools, and the state must backfill these losses, *the state's bill for local RDA activity is about \$1.4 billion each and every year.*

RDAs say that the large annual state subsidy is worthwhile because it is short-term and allows agencies to increase assessed valuation to the benefit of all local agencies (and the state) in the long run. But is redevelopment a short-term proposition?

How Many? How Old? How Long? The state's 384 active RDAs have 764 project areas. Though new RDAs face some limitations under state law, many project areas date back to the 1960s, 1950s, and even the 1940s. What happened to the original intent that RDAs are closed once the objectives of the project area have been met? On the contrary, RDAs report that their plan is to continue their project activities through 2040 and beyond! Finally, as discussed above, many RDAs have bonds that mature as many as 20 to 30 years down the road. Since these bonds are backed by future property tax increment dollars, these revenues are tied up until the bonds are repaid.

Each year an RDA operates, the state subsidizes the project area by backfilling any and all revenue losses to schools. In the last five years alone, the total State subsidy for RDAs was over \$5 billion and grew at approximately 10 percent per year. By fiscal year 2009/2010, the annual State subsidy could reach \$2.7 billion or more.

Redevelopment Gone Awry. Although RDAs have noble goals and powerful tools, some agencies abuse the letter and the spirit of redevelopment law. In the past, RDAs have declared pristine, undeveloped fields, and entire cities "blighted" and formed project areas around them. In response to some of these abuses, the Legislature passed a reform measure to tighten the definition of blight (AB 1290, Isenberg, 1993). The 1993 law has helped the courts hold the line on some RDA abuses, but others persist. PPIC's study of the state subsidy of RDAs recommended further clarification of the goals of RDAs and more precisely define "blight." These suggestions are particularly relevant given recent reports of questionable RDA expenditures around the state. RDA spending on excessive administration, duplication of private services, repeated condemnation of successful businesses (churning), and elimination of low- and moderate-income housing are particularly disturbing, especially considering the state subsidy of these activities. Here are just a few examples of errant RDA activity:

- **Exorbitant Administrative Costs.** In its analysis of the Governor's 2004-05 Budget, the Legislative Analyst reported that RDAs frequently spend more than 50% of their housing fund on planning and administration, undercut funding for

housing, and used housing funds for non-housing purposes. In other words, RDAs that are responsible for creating affordable housing for low- and moderate-income residents are not fulfilling their statutory obligation.

- Several cities spent more than 50% of their housing money on administration for four years (or more). The cities of Hercules and Rio Vista spent 100% of their funds on administration for four (or more) years.
- Duplication of Private Services. In 2003, the City of Rancho Cucamonga tried to use RDA tax increment revenues to create a new municipal utility to serve a new mall developed on vacant land, even though a private utility company already had the necessary infrastructure in place to provide electric service. State law specifies *more than one dozen times* that RDAs are only authorized to act if private enterprise cannot alleviate blight. Ignoring this prohibition, Rancho Cucamonga, and other cities, want to use RDA fund (along with the state subsidy) to enter into a municipal utility business they believe will be a source of new cash for the city general fund.
- On Again-Off Again “Blight”: In 2003 the City of Lynwood agreed to permit a car dealer to acquire a portion of what is known as Project Area 26. This property had been included in the redevelopment project area when the freeway was opened and the then existing merchants left. Over time the area's high vacancy rate disappeared. The City then landscaped and upgraded the area so that it is now an attractive commercial area. It is no longer blighted. Yet, with the conclusive presumption of blight, the City of Lynwood possesses the power to condemn the profitable businesses, remove the buildings and then sell the land to the car dealership with the promise of greater sales tax to the City and tax increment to the Redevelopment Agency.¹
 - A comparable situation is planned for the corner of Hollywood and Vine where property owned by the Metropolitan Transit Authority is being sold to a developer for a large scale hotel and commercial development. The City of Los Angeles is now seeking to reacquire the right of eminent domain so that it can acquire the privately owned property along Vine which consists of small merchants and a small office building. Two years ago the property was apparently not "needed" by the developer. But now the City has expressly stated that it will use eminent domain, if acquired, to put the existing merchants out of business.
- Elimination of Low- and Moderate-Income Housing. In 2001, the City of Ontario's RDA spent \$8.6 million to demolish 138 apartments housing low- and moderate-income residents. The RDA then sold the parcel to a developer who created 1800+ square foot single-family residences for \$300,000 to attract new executives. No replacement for the demolished low- and moderate-income residences is planned.

¹ Ironically, the car dealer could not come up with the money to commence the project and, fortunately for the business, the project fell through.

- Redevelopment Project Area No. 1 in the City of South Lake Tahoe where the Redevelopment Agency acquired and demolished 526 existing motel rooms so that Embassy Suites could construct a 400-room hotel. More motel rooms are being demolished to be replaced by the Embassy Vacation Resort, a 210-unit timeshare development. The only existing low- and moderate-income residential housing appears to be the Tahoe Pines Apartment complex that has 28-units of affordable family housing. The term "affordable", however, is not defined.
- According to the California Department of Housing and Community Development (HCD), for 2002-03, 101 RDAs were not in compliance with housing set-aside requirements (not setting aside enough money for housing).
- RDAs are allowed to destroy affordable housing units and not replace them as long as they replace the same number of bedrooms. HCD also reported that between 1996-97 and 2000-01, RDAs destroyed 4,207 housing units and replaced them with 2,756.

Cal-Tax believes these facts point to a pattern of ineffective and misguided spending on activities that do nothing at all to meet the original objective of RDA – that of eliminating blight and providing more affordable housing. Many of these activities are aimed specifically at adding to the revenue base of the RDA sponsoring city – focusing more on sales tax and other revenues than community redevelopment.

Huge Windfall to RDAs. RDAs argue that tax increment financing, and the necessary state subsidy, is needed to combat blight. But in 1998, the Public Policy Institute of California (PPIC) conducted a study of 14 RDA project areas in 10 counties. Of these, PPIC selected 38 projects in three counties for extensive study. In the sample area, RDA project areas collected \$78 million in property tax increment. But rather than praising RDAs for creating \$78 million in new property tax revenues, PPIC found ***\$38 million in tax increment would have occurred without any redevelopment activity or state subsidy.*** PPIC's research concluded that regular economic activity, without any RDA activity, would have produced more than half of the additional tax increment. If only 50% of the property tax revenue is the result of RDA activity, then RDAs are gaining a multibillion windfall in revenues annually. Cal-Tax believes any property tax growth resulting from normal economic activity in the community should go to the local government agencies and not be retained 100 percent by the redevelopment agency.

Using PPIC's logic, over half of the annual statewide RDA property tax revenue or about \$1.4 billion is a windfall to these agencies that should be returned to other local agencies in the community. Since half of these funds would be returned to local schools, the State general fund would see a savings of about \$700 million or more annually. Over the last five years, the state's subsidy of redevelopment was \$5.1 billion and grew at about 10% each year. According to PPIC, "the existing tax increment system is not an effective way to finance redevelopment." PPIC suggests that the policymakers consider how these limited public resources might be better used elsewhere.

Legislative Analyst Recommends Reform. As part of the annual state budget analysis, the Legislative Analyst reflected on the need for some RDA policy and fiscal changes. As previously mentioned, the Analyst noted that many RDAs spend more than 50% of their housing resources on planning and administration, undercutting resources available for *actual* housing.

In addition, the Analyst reviewed the Governor's plan to shift \$1.3 billion in property tax revenues from cities, counties, special districts, and RDAs to school. Under the Governor's proposal, RDAs would lose \$135 million. But the Legislative Analyst recommended increasing RDAs' property tax shift to \$320 million, so as to spare city and county general funds.

Cal-Tax Recommendations. Based on the original principles intended by the Legislature, Cal-Tax believes the following specific reforms are necessary for RDA funding and expenditures.

- Limit the amount of money that may be spent on “administrative” costs and limit the definition of what counts as an “administrative” expenditure. RDAs should not be used as tools to help balance a city's ailing budget by shifting “administrative” costs from the city to the RDA. Require more specific reporting for RDA and more strenuous audits of RDAs that continue to report high percentages of their expenditures as “administrative” costs.
- Limited state and local resources should be channeled toward combating *actual* blight, and the prohibition against duplication of available private services should be clarified and strengthened. RDA spending should be rigorously prioritized to rid the community of debilitating blight, provide better and more affordable housing for the community and coordinate those efforts with transportation projects that help get people to their jobs and move goods through the community.
- Restrict the source of property tax increment retained by RDAs to new construction only. As stated above, the three main sources for property tax growth are new construction, changes in property ownership, and the annual two percent property tax growth allowed by law. Currently, RDAs retain all property tax growth dollars regardless of the source of the growth. Limiting RDAs' property tax increment to only new construction growth would work to eliminate the property tax windfall enjoyed by RDA and would encourage RDAs to build more low to moderate-income housing when coupled with the previous bullet point.
- Identify a specific State agency to oversee and make accountable all RDAs in the State. RDAs that consistently report expenditures outside the statutory guidelines should be subject to more frequent audits and should be brought into compliance.

Conclusion. Redevelopment agencies are ripe for reform. Redevelopment money is intended to combat the very real physical and economic blight that is a scourge on our communities. But too often, it isn't. As a matter of policy, the state should not allow excessive administrative charges, duplication and competition with the private sector, elimination of low- and moderate-income housing, and multiple and repeated condemnations of the same properties. These activities are inconsistent with the intent

and, in some cases, the statutes that guide RDAs. And as a fiscal matter, the state should not *pay* for these misguided efforts and abuses. RDAs cost the state \$1.4 billion annually. With the state struggling with its own multi-billion budget deficit, and RDAs ignoring or perverting their Legislative directives, why would the state chose to devote so much of its limited resources to RDAs.

RDAs also retain every property tax growth dollar *whether or not they are responsible for bringing in that dollar*. This is just bad policy and means unnecessary sacrifice by other local agencies in the area who are in need of those dollars. RDAs should not be allowed to retain this annual multibillion dollar windfall. Instead, RDAs should retain only property tax growth resulting from new construction. All property tax growth dollars resulting from normal economic activity should be returned to these local agencies.

RDAs are state agencies, but no state agency oversees or polices them. The courts can sort out some abuses, but it is the responsibility of the Legislature and the Governor to ensure that RDAs live up to their directives and spend public resources wisely. Without vigilance and guidance from state policymakers, RDA activities are limited only by their imagination, and state taxpayers are forced to foot the bill.

This white paper was prepared for Cal-Tax by The SAER Group, a research-based public affairs and financial consulting firm in Sacramento. It was written by April Manatt, former chief consultant to the California Senate Local Government Committee, and Steven Spears, former deputy state treasurer for public finance. Ms. Manatt is the author of *What's So Special About Special Districts?* and *Assessing the Benefits of Benefit Assessments*. Mr. Spears worked in the treasurer's office from 1998 until January 2003, managing the state's \$20 billion portfolio of outstanding bonds. He also has served as legal counsel for a member of the state's tax board and was a senior legislative consultant on state budget revenue and taxation issues.