Public Choices — Private Resources

Financing Capital Infrastructure for California's Growth Through Public-Private Bargaining

John J. Kirlin and Anne M. Kirlin

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Summary

Local jurisdictions and developers are seeking new ways to provide capital infrastructure needed for population and job growth in California at a time when the traditional methods of providing public works are in disarray because of Proposition 13 and the general climate of fiscal stress. With increasing frequency, jurisdictions and developers "bargain" over how the capital investments needed to accommodate growth will be provided. This bargaining is project specific and is significantly less bound by legal constraints as to the forms it may take than traditional models of land-use decision-making. Bargaining is, therefore, different from taxation or development fees. Theoretically, both of these revenue generation instruments are applied uniformly and at set rates. In time, much "bargaining" may become routinized, so that it no longer warrants that label, becoming indistinguishable from taxation or fees. But for the next decade or so, and perhaps longer, bargaining will be an important feature of the land development process.

Bargaining occurs in many different arenas; almost every decision point in the land development process provides opportunity for bargaining. One important finding of this analysis is precisely that bargaining can occur in so many different arenas. Most commonly, bargaining shifts costs historically borne by the public sector to the private sector. These bargained costs are in addition to the normal development fees, dedication requirements, and taxes borne by the developer or others in the private sector. In some instances, the bargaining extends beyond capital infrastructure to include pursuit of a variety of public policy objectives and it may encompass mechanisms by which the jurisdiction participates in profits generated by the project.

While many developers, and others in both the public and private sectors, judge bargaining to be undesirable, we have concluded the opposite. Bargaining is desirable, first of all, because it is the best available alternative for financing public works. The pre-Proposition 13 system, which relied heavily on general obligation bonds, surplus revenue accumulation, and grants-in-aid from the federal government, is unlikely to return in the foreseeable future. We support the resurrection of local government capability to issue general obligation debt, but do not expect this to happen soon. So too do we support the expansion of other instruments for financing capital infrastructure, such as special assessments, but expect these instruments to never supply all needed capital investment.

Until older mechanisms for provision of capital infrastructure are resurrected or new instruments developed, bargaining must be recognized as currently contributing a very large share of public works financing at the local level. In 1980, for example, California local governments issued $76 million of general obligation debt (authorized by voters before passage of Proposition 13; because Jarvis-Gann effectively destroyed future authorizations, this instrument will soon be totally unavailable), $97 million of special assessment bonds, almost $900 million of revenue-backed bonds and $213 million of lease revenue debt instruments. A single "bargain" (Rancho Carmel, in San Diego County) will provide $85 million in capital infrastructure that would historically have been borne by the public sector. No compilation of the state-wide volume of public works provided through bargaining is available, but it must represent a substantial share of the total — almost certainly exceeding general obligation and special assessment bonds and perhaps rivaling revenue bonds.

Given the stress on public revenues, constraints upon bargaining would lead to further reductions in public works. In time, this will curtail the growth of California, driving housing prices upward, and discouraging job creation both by firms already operating in California and new firms. We judge these consequences to be undesirable in the long run and expect the pressures for growth to be so great that virtually any obstacle will be somehow overcome. Some Californians will judge a future with less growth more favorably.

Accepting bargaining as a legitimate process does not mean giving up public policy control over the extent, timing, and character of growth and development. Indeed, because bargaining occurs on a project-specific basis "above and beyond" existing taxes, dedication requirements, and development fees and can fit into whatever planning and policy making process is used by a jurisdiction, it offers new opportunities to pursue public policy objectives. This is the second reason bargaining is acceptable: it is fully consistent with strong, effective public policy.

Nor does bargaining require abridging procedural safeguards of private property rights. The statutes and court decisions supporting these rights still exist. Jurisdictions can seek to unreasonably exploit their monopoly position in the control of land use to violate rights to the use of private property. But this is not bargaining, but rather exaction, extortion, or blackmail.

One expert in local government finance and land development has used a sports analogy to express fears concerning the potential for turning bargaining into exaction. In this sport, the jurisdiction establishes the rules of the game, identifies who may play, serves as referee, controls the clock, has the right to stop the game at any time it chooses, decides who wins or loses, and may alter the outcome of the game long after it is over.

While bargaining provides no new legal safeguards against such abuses, it does afford the opportunity for landowners and developers to more openly pursue and defend their interests. The agreements struck as a result of bargaining are not always firmly rooted in the law; sometimes, this analysis reveals, they stretch the bounds of legality. But if the parties at interest — the developer and jurisdiction — *do* reach an agreement (without undue

force on one side), it is hard for an outsider to fault the equity of that agreement. Only the affected parties know the value of what each has given and received. This is the third reason bargaining is acceptable: private property rights are not diminished.

A fourth reason to support bargaining is that the consequences of its widespread use are acceptable. In some regards, they are preferable to the pre-Proposition 13 system. For example, the ultimate incidence of increased costs imposed upon developers through bargaining should fall upon the owners of developable land. While barriers to this shift exist, such as limited supplies of developable land, it is the most likely ultimate pattern of incidence. Of course, in some locations and in the near term, developers, home purchasers, or others will bear much of the increased costs.

Under the old system, landowners could receive windfall profits if broadly-funded public works projects increased the value of their parcels. As bargaining becomes more widespread, developers are likely to reduce the purchase price of land to cover these new costs, thus capitalizing the shift from public to private financing in lower prices for developable land. Beyond this general incidence effect, some potentially troublesome consequences of bargaining, such as favoring large projects proposed by large, well-funded development firms, can be addressed by specific public policies intended to counter these biases.

A fifth reason that we judge bargaining acceptable is that when both jurisdictions and developers are risk averse and prefer delaying capital outlays, they find that many forms of bargaining are preferable to the old instruments for providing public works. This is almost always the case for jurisdictions and can be so for developers.

Finally, bargaining is, according to the analysis presented here, defensible against legal attack. In particular, presumed prohibitions against "contracting away" the police powers of local jurisdictions are surmountable. Several specific approaches to the procedures used for bargaining and features to be included in any resulting contracts between jurisdiction and developer intended to minimize legal challenges are presented. A second set of legal issues, revolving around the transfer of administrative and legal tasks from the jurisdiction to the developer, is also discussed. In this case, it is suggested that the preferable strategy, both legally and politically, is for jurisdictions to develop their own expertise or seek independent consultants and counsel for assistance.

Bargaining may lead to several abuses. Because it is not legally constrained, it can be the occasion for diminishing rights to private property. This can occur if bargaining exacts so much value from a site as to raise issues of uncompensated taking of private property for public purposes. If bargaining results in unpredictable and capricious approval of proposals for changes in land uses, it can violate norms of procedural equity. Bargaining may also provide additional opportunities for bribery and influence-seeking through campaign contributions. The potential for these abuses may be reduced by various procedures. In any case, it must be noted that these abuses can occur in any system of land use. They should be guarded against,

but bargaining should not be rejected because of fears of these abuses.

At a more abstract level, bargaining is another step in the movement from exclusionary zoning (which emphasized what uses were not allowed on specific parcels) toward inclusionary zoning, where public policy specifies the allowable uses. In this regard, bargaining is similar to much recent land use policy made to pursue environmental protection or social policy goals such as affordable housing. Whereas land use policies in this nation historically emphasized rights of private property, they now emphasize public policy objectives. The present land use system in California is most appropriately considered neo-feudal in character, as public jurisdictions control land uses in many of the same ways as did feudal sovereigns. Even for this reason, however, bargaining should not immediately be rejected. In the present context, the alternative to bargaining is often no change in land uses: an extreme limit upon private property rights.

The last chapter of this volume analyzes the policy choices that could be made to facilitate successful bargaining. Most important are the choices available to the state, but choices available to local jurisdictions, developers, and financial intermediaries are also presented.

While those public officials and developers already involved in bargaining of the sort analyzed here should find something of interest in the volume, our intended audiences are those who have not yet attempted such bargaining, who remain uncertain as to its desirability, or who have doubts as to how to use this process effectively.

1

Investment in the Growth of California

California, were it a nation, would have the world's eighth largest economy, just smaller than the United Kingdom in GNP and larger than Canada, Italy, Brazil, Spain, and Poland (Security Pacific National Bank, 1979). Per capita personal income, population growth and employment growth are all well above the national average. Current estimates project an additional five million inhabitants for the state by the year 2000. Both population and employment growth require investment. Some of this investment, in the capital infrastructure of roads, water and sewer systems, schools, and other service facilities, for example, has traditionally been provided by the public sector. Much of the investment associated with growth occurs in the private sector, such as the capital investment associated with creating employment and housing. Rarely, however, can a category of investment be assigned solely to the public or the private sector: developers build roads and dedicate them to cities or counties, and both public and private sector investments are made in energy provision, for example.

Data on the full magnitude of the capital investment associated with the growth of California is not available, although one set of estimates discussed shortly suggests that each additional inhabitant requires more than $50,000 in private and public capital investment. While the exact magnitude of this future investment is not known, we do know that the traditional patterns for the provision of capital infrastructure are changing. High and volatile interest rates impede debt issuance and borrowing in both the private and public sector. The state and local public sector nationally is experiencing fiscal constraint caused by decreases in tax rates, imposition of fiscal limits, and declining federal grants in aid. The constraints upon California governments caused by Proposition 13 are much discussed, although their full impacts — especially on capital investment — are not well understood.

But fiscal constraint in the public sector does not quench pressure for growth. A growing trend among California governments is to shift costs of providing the capital infrastructure required for growth to those who are seeking that growth. These are most commonly developers of residential subdivisions, commercial projects, and industrial parks, but also include individual industrial firms.

This practice of shifting capital infrastructure costs from the public to

the private sector is the subject of this analysis. Evidence concerning the extent of such practices, their rate of growth, and their impacts is offered. The primary objective of the analysis is to provide an initial (but not exhaustive) appreciation of this phenomenon and to project its likely consequences if more widely practiced, which is our prognosis. The balance of this chapter examines available evidence on the magnitude of the investment needed to accommodate projected growth, concluding with a preview of the issues addressed in subsequent chapters.

Those familiar with the development process know that local jurisdictions have historically required developers to make certain capital improvements. Two procedures have been used most frequently: dedication requirements and fees. Common dedication requirements are that a developer build streets, storm sewers, sewerage lines, or curbs and gutters to the specifications of the local government in which the development occurs, dedicating them to that jurisdiction upon completion. Fees are typically levied according to the total cost of the project, the number of units, number of parking spaces, or some other measure. Such fees must be used for purposes reasonably related to the project in question (Longtin, 1977: 248-250) and related to the costs incurred (Government Code Section 54990; Article XIII B of the California Constitution).

A 1980 survey by the Association of Bay Area Governments found that development fees averaged nearly $3,000 per residential unit and were related to such varied purposes as storm drains, sewers, school impacts, and parks (ABAG, 1980). Cities, counties, and schools frequently review and update these fees, which are likely to continue to increase as one strategy for shifting the financing of capital infrastructure to the private sector.

Dedication requirements and development fees are not the focus of attention in this document. Both of these instruments share two common features not found in the practices being examined here: they are applied uniformly and must bear a reasonable nexus to the impacts of the project upon which they are levied. "Bargained" arrangements do not share these two features. They are not applied uniformly to all equivalent projects, but are the product of case by case negotiation. And they need not relate to the immediate project upon which they are imposed. In some cases, the jurisdiction is seeking to shift costs to new development that are equivalent to the property taxes that would have been generated by the project if Proposition 13 had not passed. In short, they seek to reestablish the pre-Proposition 13 decision rules for financing new development. In other cases, the jurisdiction receives a stream of revenues into the future with neither the developer nor jurisdiction knowing how the revenues will ultimately be spent.

Estimating the Need For Capital Investment

Available evidence suggests that public sector capital investment in California lagged behind growth rates in the 1971-1977 period, a contrast to the 1960's when higher capital expenditures occurred. Jamison (1979), analyzing data collected by the Bureau of Census, calculated that California state and local governments underspent between 25% and 30% annual-

ly during this period (compared with a national "norm" of expenditures per $1,000 of personal income as the average for the remaining states).

The impacts of Proposition 13 upon public sector capital investments are not yet fully understood. State and local bond sales increased 54.6% from fiscal 1977-78 to fiscal 1979-80, but this is attributable to a stunning increase in the issuance of housing bonds (up 439.1%); non-housing bonds fell by 19.2% during this period (Legislative Analyst's Office, 1981: A-56). A survey by Kevin Bacon (1981: V, XV) of the Assembly Office of Research found that capital expenditures by cities rose by 14.2% between fiscal 1977-78 and fiscal 1979-80 (but fell by 2.5% in constant dollars), while capital expenditures by counties fell in both nominal (27%) and constant (37%) dollars in this period.

Table 1.1 presents statistics on total debt issuance by California governments in 1980, as compiled by California Municipal Statistics, Inc. Clearly shown is the large volume of mortgage revenue backed issues. Also of importance are the relative shares in the volume of issues attributable to the state and to local agencies. The state issued approximately 30% of the new debt and local agencies 70%.

As the sale of housing bonds is now constrained by federal and state regulation, capital expenditures have probably been generally depressed since adoption of the Jarvis-Gann Initiative. If housing bonds are excluded on the grounds that they are different than the traditional public works required to accommodate growth, and notes are excluded on the grounds that they do not provide long term financing, only $1.5 billion of long term debt was issued by California state and local governments in 1980. This decline would fit the nation-wide pattern of state and local debt issuance which declined from 3.6% of GNP in 1970 to 2.9% in 1980 (Kirlin, 1981). The 1970s was also a decade of erratic investment in the private sector, which fluctuated around 10% of the nation's GNP, but the rate of growth in the capital stock available per worker fell substantially because of growth in the labor force (Council of Economic Advisors, 1980:16-137).

No analysis of the total public and private investment needed to accommodate future growth in California is presently available. A model for such an analysis is available in a recent effort by the State of Colorado (1981). That analysis projected a need for $89 billion in total private and public investments (1980 dollars) to accommodate an additional 1.6 million inhabitants over the next two decades, of which 70% was estimated to be private sector and 30% public sector investment. As a very rough projection of the needs for investment in California for the equivalent time period, the ratio of population growth to projected investment can be used, suggesting that each new inhabitant requires $55,600 in capital investment. If five million more Californians live in the state by the year 2001, $278 billion total investment would be required, and if the projected private-public split used in the Colorado study is also employed here, $195 billion would come from the private and $83 billion from the public sector. On an annual basis, this would require $4.15 billion in state and local government capital investments over the next 20 years. Such a level of capital investment would be nearly three times larger than the amount of long term, non-housing debt issued in California in 1980.

Table 1.1: Total Debt Issuance by California State and Local Governments, 1980

(listed by issue security, in thousands of dollars of par value)

Security	State of California	Local Agencies	Total
Mortgage Revenue[1]	$ 911,000	$1,066,365	$1,977,365
Revenue[2]	73,000	821,765	894,765
General Obligation[3]	520,000	75,793	595,793
Lease Revenue	—	213,250	213,250
1915 Act	—	81,344	81,344
Tax Allocation	—	63,600	63,600
Pollution Control Revenue	35,185	—	35,185
Benefit Assessment	—	16,545	16,545
Less State Veterans Issues Duplicated	350,000	—	350,000
Total Long Term Issues	$1,189,185	$2,338,662	$3,527,847
Total Note Issues	$ 50,000	$ 744,291	$ 794,291
Total Debt Issues	$1,239,185	$3,082,953	$4,322,138

1. Includes State Veterans, H.F.A., Home Purchase, Military Home Purchase, and Faculty Mortgage issues.
2. Excluding mortgage revenue bonds.
3. Includes State General Obligation Veterans issues, 3 issues totaling $350,000,000.

Source: Adapted from: California Municipal Statistics, Inc. *State of California 1980 Municipal Financing.* San Francisco, n.d.

A more conservative estimate of needed public sector capital investments is provided if the experience of the 1970s is used as a basis for projection. In the 1971-77 period, the population of the state increased by 1,571,000 while state and local capital investments totalled $18 billion, for an average per capita capital investment of $11,843. Applying this figure to a projected population increase of five million yields an estimated need for public sector capital investments of $59 billion, approximately 71% of the estimate yielded when the Colorado-derived projection is used. On an annual basis, this would require $2.95 billion in state and local government capital investments over the next 20 years, still approximately two times more than recent levels. It should be noted that the 1971-77 base period is a period of depressed capital investment by the California public sector, falling below the levels of the 1960s in the state in constant dollars per capita or the experience of other states when adjusted to levels of personal income.

This analysis seeks to illuminate only a part of this total need for capital investment, focusing upon the financing of the public improvements needed for new developments. Historically, developers subdividing land for any purpose have borne the cost of certain "public" improvements, with a common example being the construction of roads within the subdivision which are then dedicated to the city or county serving the area.

Significant changes in this historical practice are now occurring, largely in response to the fiscal constraints occasioned by Proposition 13 and the decline in federal grants in aid. Local governments are bargaining more aggressively with developers, shifting more capital investment costs to them. A second changed feature is found in a dramatic expansion of the structures through which this bargaining over public improvements takes place. Finally, the state of California is now more frequently a party to these processes. Because of shortage of funds, CalTrans is increasingly interested in developers (and local governments) undertaking improvements that would previously be funded by the state (e.g., from constructing intersections, to freeway offramps). Assembly Bill 893 (Roos), the California Communities Act, would have further inserted the state into these processes, giving it authority to negotiate with the developers of up to five new cities, the capital infrastructure for which would be totally provided by the developer or through a community development district financed by property tax increments. In another example of state involvement, a specially created state task force extracted an agreement from county and city officials in the rapidly growing Roseville area east of Sacramento concerning provision of low and moderate cost housing as a condition of constructing a state highway project.

The next chapter of this analysis briefly recounts how fiscal constraints will challenge the capacity of California state and local governments to accommodate growth. Chapter 3 enumerates the variety of legally defined arenas in which bargaining concerning capital investment takes place, a list which is now markedly longer than only a decade ago. Chapter 4 presents another overview of bargaining, distinguishing among types of agreements reached by jurisdictions and developers. Chapter 5 presents several minicase studies of how developers and public jurisdictions provided needed capital investment. An evaluation of differing perspectives upon this bargain-

ing (by role: local jurisdiction, developer, financial markets, citizens, etc.) is undertaken in Chapter 6. Chapter 7 attempts to assess the potential of this strategy of shifting more of the costs of providing capital infrastructure to the developer. Developers will probably be impacted by this new pattern, which may for example, advantage those who are larger and with greater capital reserves. And as they will seek to shift much of these costs to others involved in the development process, there are likely to be incidence effects that extend well beyond developers. So too may there be effects upon the location, pace, and types of development. These potential consequences of this mode of providing capital infrastructure will be examined in Chapter 8. Chapter 9 examines legal issues attendant to this strategy. Finally, Chapter 10 discusses policy choices for both the public and the private sectors occasioned by the likely increase in bargaining over the distribution of costs and benefits associated with growth.

2

The Challenge of Fiscal Constraint

Californians usually think of Proposition 13 when "fiscal constraint" is mentioned. The Jarvis-Gann Initiative did dramatically impact fiscal affairs in California, but it is only one element of the fiscal constraint that is challenging traditional modes of accomplishing public purposes. This chapter briefly analyzes both the national and California experience with fiscal constraint.

The first important conclusion emerging from this analysis is that the movement to fiscal constraint is widespread, deeply rooted, and very powerful. The most likely scenario for at least the next decade is continued fiscal constraint, with the consequence that California state and local governments will be hard-pressed to meet demands for both operating and capital investment funds.

A second, less obvious attribute of fiscal constaint is that the long run consequences of the arrival of fiscal constraint result more from the responses elaborated to it than from the reduction in available funds. This conclusion is not at all obvious, particularly in the initial experiences of fiscal constraint when revenue reductions loom large. But it is an accurate observation nonetheless, finding justification in two phenomena. First, the responses to fiscal constraint change the political system itself (e.g., the relationships between the state and local governments), with impacts upon virtually all dimensions of the public sector. Most importantly, capacity to adjust to future changes is affected, as happens when the power of the state vis-a-vis local governments is increased. Second, the public sector possesses instruments (e.g., taxation or regulation) by which policy objectives may be pursued with dramatically less direct public expenditures than was the norm in the 1965-75 period. If appropriate responses are developed, most public policy objectives are as likely to be achieved under fiscal constraint as in eras of a plumper public purse.

When Proposition 13 passed in June 1978, it was popularly perceived as an unusual, dramatic event. This perception was held not only by the citizens, but also by the political elite of California who had overwhelmingly opposed the initiative. Closer analysis reveals that Proposition 13 was part of a larger fiscal constraint movement that had begun in 1976 and which has continued since June 1978.

Table 2.1 shows how state and local expenditures grew until 1975 and then declined, as did debt issuance, a proxy for capital expenditure. Increasing, then declining federal aid explains part of this pattern, but most of the increases and decreases occurred as the result of decisions made by state and local governments themselves, as shown in the columns reporting expenditures from the funds they raised. In the 1959 through 1976 period, for example, Shannon (1981) reports that states increased existing taxes or imposed new taxes in 627 instances. In the 1977-80 period, in contrast, all but eight states reduced taxes, indexed the personal income tax, or adopted one of the four forms of contemporary fiscal limits (full disclosure laws, property tax levy limits, expenditure lids, or assessment constraints). Thirty-six states reduced personal income taxes, 22 reduced general sales taxes, nine indexed the personal income tax, 84 state actions were taken to restrict local government taxes an expenditures, and 31 states adopted some form of fiscal limit.

In California, Proposition 13 reduced local government revenues by $7 billion, equivalent to 22% of total local government expenditures at that time. Transfer of funds from the state ($4.4 billion in fiscal 1978-79; $4.9 billion in fiscal 1979-80; $5.4 billion in fiscal 1980-81; and $6.0 billion in fiscal 1981-82) eased the local government revenue reduction. The state was able to make these transfers because of an accumulated surplus of general fund revenues in excess of general fund expenditures and the continued growth in its revenues. These transfers were directed overwhelmingly to schools and to health and welfare functions of counties, which totalled 80% of the transfers in fiscal 1978-79, for example. As a consequence, available funds for other functions performed by counties and for all city functions have decreased. For example, Bacon (1981) found that per capita city discretionary revenues expressed in constant dollars fell 4.3% between fiscal 1977-78 and fiscal 1979-80, and county revenues similarly measured fell 12.4%.

As a general indication of economic status four budget cycles after passage of Proposition 13, general (non-education) state employment is up 5.9%, counties are down 0.6%, cities are down 8.5%, local school districts are down 4.4%, and special districts are up 5.9% (source: Employment Development Department, State of California, comparing May 1981 to May 1978). The fiscal capacity of cities and counties, the local governments whose land use policies control development, was reduced by the loss of property tax revenues under Proposition 13 and the increased fiscal assistance from the state has done little to alleviate this revenue loss.

Indeed, in its first fiscal assistance bill, for fiscal 1978-79 (SB 154), the state Legislature did not even provide for the allocation of increased property tax revenues resulting from new development to the jurisdiction in which it occurred. This feature of SB 154 was a powerful disincentive to allowing new development. Assembly Bill 8, the fiscal assistance bill for fiscal 1979-80, remedied this defect, returning property tax revenue growth to the jurisdiction in which the new development occurred, the policy which is still in effect. (In the case of annexation, AB 8 provides for a "negotiated" exchange of property tax revenue between the county and the annexing jurisdiction.) Even so, Proposition 13 has impacted local governments' land use decision

Table 2.1: Fiscal Constraint of State and Local Governments

(expressed as a percent of GNP for selected years)

Calendar Year	Total State and Local Expenditure	Federal Aid	State Own Funds Expenditure	Local Own Funds Expenditure	State and Local Debt Issuance
1949	7.8%	0.9%	3.4%	3.5%	—
1959	9.6%	1.4%	3.8%	4.4%	1.9%
1969	12.6%	2.2%	5.3%	5.1%	2.5%
1974	14.3%	3.1%	6.0%	5.2%	3.7%
1975	15.2%	3.6%	6.3%	5.3%	3.7%
1976	14.7%	3.6%	6.1%	5.0%	3.3%
1977	14.3%	3.6%	5.8%	4.9%	3.5%
1978	14.2%	3.6%	5.8%	4.8%	3.2%
1979	13.4%	3.3%	5.6%	4.5%	2.7%
1980	13.4%	3.3%	5.7%	4.4%	2.9%

Sources: Columns 1-4 from: John Shannon, "The Great Slowdown in State and Local Government Spending in the United States: 1976-1984" (Washington, D.C.: Advisory Commission on Intergovernmental Relations, June 1981). Column 5 from: John J. Kirlin, "An Analysis of The Demand for Debt Issuance by State and Local Governments" (Napa, Ca.: manuscript prepared for Citibank, 1981).

making, making most developments, and especially residential projects, less desirable as the reduced revenues they produce are less likely to cover additional costs incurred in extended capital infrastructure and providing ongoing services (Chapman, 1981; Office of Planning and Research, 1979, 1980).

The most important impact of Proposition 13 upon local governments' ability to sensibly make land use decisions is the uncertainty that exists concerning their long term fiscal status. Future revenues are uncertain partially because more initiatives affecting revenues could pass. Proposition 4, the Gann Initiative limiting revenues, passed in 1979, is now beginning to have impact. Proposition 9, which would have cut income tax rates in half and permanently and fully indexed them for inflation was defeated. But more initiatives will be voted on in 1982, and more attempts to quality initiatives cutting government revenues are likely as long as citizens' disposable personal incomes are not growing in real terms. If an initiative passes which affects local revenues, the state has little capacity to provide replacement revenues because it is now experiencing annual deficits. If the initiative reduced state revenues, the state would almost certainly reduce its present assistance to local governments. Even without another revenue-cutting initiative, the state is experiencing difficulty covering budgeted expenditures in fiscal 1981-82. Given the projected revenue shortfall in fiscal 1982-83 of $2 billion or more, strong pressure will exist to reduce fiscal transfers to local governments.

Local government expenditure responsibilities are also uncertain. Despite nearly a decade of legislative prohibitions (the SB 90 process) and a constitutional prohibition imposed by Proposition 4 in 1979, the state continues to enact legislation imposing what local governments consider to be unfunded mandates. Proposition 4, of course, also imposes expenditure limits upon California governments.

An additional source of local government fiscal uncertainty, for both revenues available and expenditure responsibilities, is the policy initiatives of the Reagan administration. For example, major revisions and reductions are proposed in the Section 201 grant program which has provided financing for sewage treatment facilities. The state will also be impacted by these changes, and substantial changes in national-state government relationships will lead to compensating adjustments in state-local fiscal relationships.

One specific aspect of Proposition 13 of immediate relevance to this analysis is its impact upon the capacity of California local governments to issue general obligation debt. California Municipal Statistics, Inc., calculated the decline in general obligation issues of California local agencies as follows:

Year	Number of Issues	Par Value
1976	117	$488,768,000
1977	105	$444,162,000
1978	110	$377,487,000
1979	58	$243,029,000
1980	20	$ 75,795,000

General obligation issues coming to market after June 1978 were authorized by voters before passage of Proposition 13; as these authorizations are exhausted, no further general obligation debt will be issued by California local governments.

Fiscal constraint and uncertainty are encouraging California governments to rethink the ways in which development occurs and the capital infrastructure and continuing services required for that development are provided. One response is to attempt to slow growth (Office of Planning and Research, 1980). But the pressures for growth are strong in California, so this strategy is not likely to be wholly successful. However, one analysis suggests that future increases in the price of housing in the state could substantially depress growth in the economy, so this prospect should not be dismissed lightly (Kimbell and Shulman, 1980). That analysis projects a total California population virtually identical to that used in Chapter 1 of this study. After housing prices have constrained growth, Kimbell and Shulman project a California population of 30.3 million in the year 2000, versus 52 million inhabitants if recent job creation trends are translated into population growth unfettered by high housing prices.

A second response is to encourage only developments for which expected tax revenues equal or exceed expected expenditures. In most instances, this strategy encourages industrial and commercial development, especially projects (e.g., shopping centers) that yield high sales tax revenue. This is a well-developed strategy, and the combinations of projected tax revenues and capital infrastructure provided by the developer under traditional dedication policies (e.g., streets or curbs and gutters) make some projects economically feasible for local jurisdictions.

In some instances, enough "surplus" revenues are generated by commercial and industrial projects to allow for approval of residential projects which do not provide sufficient revenues to cover required expenditures. This strategy is more risky in the post-Proposition 13 environment than previously because the governor and state Legislature have shown a willingness to shift tax base among jurisdictions, making long-term revenue projections chancy. In 1979, for example, Governor Brown proposed shifting all property tax revenues to schools and then Speaker of the Assembly Leo McCarthy advocated shifting sales tax revenue from cities and counties to schools. Neither of these proposals was ultimately adopted. Instead, property tax revenue was shifted from schools to cities and counties. In 1981, tax revenues from the unsecured property roll which would have otherwise gone to cities and counties were reduced by the state to help balance its budget. As a consequence of this evident willingness to shift tax base among jurisdictions to roughly balance growth in revenues among all types of local governments, cities and counties making land use decisions regarding development should be wary of long-term revenue projections.

The final type of response to the diminution of government fiscal capacity in the face of continued pressures for development is to shift more of the costs historically borne by the public sector to developers. This phenomenon is the subject of this analysis and receives extended attention in subsequent chapters. At this point, however, a distinction between two variants of this

response may be made. The first variant entails the imposition of new or increased fees and dedication requirements upon development. As discussed previously, fees are levied on some standard unit (e.g., per bedroom). An example of this strategy is found in the state provision that allows counties to establish fees upon new development to fund the provision of new school facilities. However, new fees are vulnerable to the charge that they are, in fact, special taxes subject to the provisions of Proposition 13.

The second variant relies not upon uniform exactions, but upon bargaining between a developer of a specific project and public officials, resulting in an agreement that the developer will undertake activities or provide funds or revenues to the jurisdiction which are specific to that project. It is this sort of bargaining that is the principal focus of this analysis. Of course, the revenue-expenditure calculations of any project include the uniform tax and fee revenues applicable in the jurisdictions where the development occurs. The bargaining which occurs over proposed projects commonly takes this revenue as given and seeks to acquire sufficient additional revenue or shed sufficient public sector responsibilities to make the development fiscally appealing.

The next three chapters explore this bargaining process, seeking understanding of the range of types of bargains which occur. Attention is also given to the variety of institutional and policy contexts in which bargaining takes place.

3

Arenas in Which Bargaining Between Developers and Jurisdictions Occurs

This chapter discusses the various regulatory frameworks and policies that provide a context for bargaining. The types of bargains themselves, as distinguished from a variety of contexts, are explored in the next chapter. Chapter 5 presents more details on several of the examples of bargaining that are only briefly mentioned here. A considerable variety of occasions or arenas for bargaining are evident, and this variety and plenitude is one of the major findings of this analysis. Save the smallest of development projects (e.g., construction of a single or very few residences), virtually every project is potentially subject to bargaining of the sort described here. The arenas in which bargaining can occur are so numerous, the fiscal constraint of California governments sufficiently severe, and the pressure to develop sufficiently intense, that development can be limited to instances where bargaining is successful.

"Bargaining" between private applicants for development permits and local public entities was recognized and encouraged as a matter of express public policy by the state Legislature's enactment in 1979 of California Government Code Section 65864 et seq., entitled "Development Agreements." The Development Agreements law constitutes a critical response to California's harsh interpretation of vesting, in which a developer does not secure the right to proceed in the face of new laws until he has secured and relied substantially upon his last discretionary permit. This law is based upon legislative findings that the increasing lack of certainty in the approval of development projects wastes both public and private resources, escalates the cost of development to the consumer, and discourages private investment in land developments. The Legislature sought to address these issues and restore private commitment to the public planning process. Briefly stated, the Development Agreements law authorizes local governments to enter into binding "development agreements," which provide assurances and protections against subsequently enacted local laws and regulations which might otherwise make the project infeasible or impossible. In exchange for this security, the contract relationship enables the locality to require the developer to provide public improvements, facilities, or services which could not be properly required as a condition of subdivision or

other development permit approvals (League of California Cities, *Development Agreement Manual*, 1981).

However, little recognition has been granted to the extensive negotiation and bargaining between local governments and developers already occurring under the umbrella of existing laws impacting on land development. It is noteworthy that in some cases such public-private bargaining or trading of incentives and compensations is occurring in regulatory spheres where, on the surface, such relationships appear to be proscribed by constitutional principles and statutory provisions.

The following section identifies some of the many forms of such bargaining occurring within the framework of existing laws. The descriptions in the chapter are brief; they do not explain how to strike a bargain and define the terms. Rather this analysis is designed merely to stimulate discussion and new perspectives on the relationship between jurisdictions and developers. In an era of tight fiscal constraints on government and high risk and uncertainty in the public planning process, both the public and private sectors have begun to recognize the benefits to both parties in a more open, creative approach to land development and provision of public improvements and services. Figure 3.1 sets forth a listing of bargaining arenas, identifying each by the legal authority which creates the context for bargaining.

Development Agreements

(California Government Code Sections 65864 et seq.)

The history and function of such agreements were discussed briefly above. The legislation governing the development agreements is significant in that it expressly authorizes localities and developers to contract in a broad manner for mutual benefits, as opposed to the traditional unilateral regulation of land development by the public agency.

Numerous jurisdictions have reportedly entered into developer agreements. Three examples, all in the County of Napa, illustrate the process:

1) The agreement governing the phased implementation of Napa Meadows Subdivision, a proposed 434 unit residential development;

2) The agreement governing the phased development of an additional 280 residential units of the Silverado Country Club, a mixed residential-recreational and commercial development; and

3) The agreement governing improvement and expansion of the Meadowood Golf and Racquet Club, a commercial recreational development.

All three agreements arose in a local climate of growth control which led to county imposition of density reductions and phased project implementations. In entering these agreements the primary objectives of the developers were to secure vesting against future changes in local law for phased long term projects and to gain adjustments in certain other proposed conditions of approval. The county secured phased development and other benefits to the public, including:

a) up front installation or construction of major public improvements (for

Figure 3.1: Major Bargaining Arenas, Defined by Legal Bases

Development Agreements (California Government Code Sections 65864-65869.5)
Redevelopment Law (California Health and Safety Code Sections 33200 *et. seq.*)
Density Bonus Incentives for Affordable Housing (California Government Code Sections 65915-65918)
Transferrable Development Rights (Local Ordinances)
Subdivision Map Act (California Government Code Sections 66410 *et. seq.* and Supporting Local Ordinances)
Assessment Districts (in particular, the Improvement Acts of 1911, 1913, 1915; Debt Limit Act of 1931, set forth in the California Streets and Highways Codes; and the Subdivision Map Act, *supra*)
Annexation Agreements (California Government Code Sections 56000 *et. seq.*, Sections 3500 *et seq.*, and Sections 54733 *et. seq.*
California Environmental Quality Act (California Public Resources Code Sections 21000 *et. seq.*, and 14 California Administrative Code Sections 15000)
Specific Plans (California Government Code Sections 65450-65453)
California Coastal Act (California Public Resources Code Sections 31000 *et. seq.*)
Local Growth Management and Building Permit Allocation Systems
Zoning and Building Code Administration (California Government Code Sections 65800 *et. seq.*, California Health and Safety Code Sections 17910-17995, and local ordinances)

example streets, parks, or drainage systems) in advance of needs created by the phased project; or

b) covenants by the developer to retain significant acreage in open space or large lot size; or,

c) financial contribution by the developer to an off-site improvement project not directly related to the project.

Redevelopment Law

(California Health and Safety Code Sections 33000 et seq.)

The redevelopment arena is somewhat unique in that bargaining and formal contracting between jurisdictions and developers have long been established parts of the process. Moreover, because of the usually large scale

of public and private investment in a redevelopment project, the bargaining that has occurred has been particularly sophisticated. The reduction in tax increment financing available for redevelopment caused by Proposition 13 has further stimulated creativity and transferred an increasing portion of costs to the developer. Through a variety of financial mechanisms, developers are reported to have advanced funds to the redevelopment agency for planning, property acquisition, or relocation expenses. Developers may be required to directly provide or make funds available to the construction of off-site improvements. A clear understanding of current jurisdiction-developer cooperation in the redevelopment process and the potential for innovative jurisdiction-developer bargaining in other arenas can probably only be achieved by a review of some specific case studies. In this regard, the reader is referred to Chapter 5 in which several innovative public-private redevelopment agreement are more fully described.

Density Bonus Incentives for Affordable Housing

(California Government Code Sections 65915-65918)

In 1979 the California Legislature enacted a variety of new code provisions, including those establishing density bonus incentives, designed to stimulate housing production. The legislation cited above provides that if a developer of housing agrees to allocate at least 25% of the proposed units for persons of low and moderate income, the locality shall enter into an agreement with the developer to either grant a density bonus or provide not less than two other bonus incentives for the project. Significantly, the legislation then sets forth an expressly non-inclusive list of other potential bonus incentives and thereby provides an avenue for creative, open negotiation between developers and local entities. As this legislation is new, little information is available on its actual use to date.

Transfer of Development Rights

Under local ordinances authorizing the transfer of development rights (TDRs), the owner of land zoned for a specified intensity of use is permitted to develop his parcel above that intensity by purchasing "development rights" from other property owners in the zone who contract not to utilize the full development potential of their parcel. The transfer of development rights is significant in that it breaks the tie between a particular site and its development potential by permitting the transfer of all or a portion of that potential (for example, the right to build an additional 10 stories) to land where greater density is desired and acceptable.

Transfer obviously provides an arena for bargaining between the affected property owners. However, local government itself may act as an intermediary to identify and to facilitate, even orchestrate, TDR opportunities between owners or among several parcels under common ownership. In such situations, TDR can become an effective vehicle for developer-jurisdiction bargaining.

Subdivision Map Act

(California Government Code Sections 66410 et seq. and Supporting Local Ordinances)

In the subdivision process, negotiations between developers and localities focus on the reasonableness or appropriateness of proposed conditions of approval or payment of development fees authorized by the Map Act. Theoretically, conditions of approval and subdivision fees must be limited to those bearing a reasonable relationship to public needs created by the development (Longtin, *supra*, pp. 248-250). However, particularly for major subdivisions, the review of project plans and supporting environmental documents may be lengthy and very complex. Such a process is conducive to legitimate debate and negotiation between the applicant and public staff over the reasonableness of proposed conditions of approval or required fees. Moreoever, in order to expedite a lengthy and costly process, developers sometimes find themselves practically compelled to "voluntarily" accept conditions which they believe are not related to their project but which rather substantially benefit other properties or the public in general. Once having voluntarily accepted a debatable condition of approval or fee charge or having taken actions pursuant to an approved permit or map, the developer may be estopped to challenge the validity of said condition. *Pfeiffer v. City of La Mesa* 69 CA 3d 74, 174 CR 804 (1977);*McDougal v. Imperial County* 98 SCt. 294, 434 U.S. 899, 54 LEd2d 187, denying application *Imperial County v. McDougal*, 19 C 3d 505, 138 CR 472, 564 P 2d 14.

The Map Act provides another area of potential bargaining between subdividers and local jurisdictions. From the perspective of a fiscally constrained local entity, the Map Act provides that the jurisdiction may require a subdivider to participate in a benefit assessment district for certain specified types of improvements. Alternatively, the jurisdiction may require the subdivider to install at his expense over-size public improvements expressly for the benefit of properties outside the subdivision (California Government Code Sections 66485 et seq.). These code provisions then provide that the local entity shall enter into a reimbursement or payback agreement with the subdivider. The local jurisdiction itself may then levy a fee or charge upon the properties benefited to pay the cost of reimbursement to the subdivider. In this manner, the subdivider is required to act as a banker for the locality and other benefited properties with, practically speaking, a long delay and often little chance of achieving full reimbursement.

It is noteworthy that two California charter cities — San Diego and Vallejo — have adopted detailed local ordinances designed to facilitate and encourage the provision of capital infrastructure by private developers. These ordinances are modelled after the concept of reimbursement agreements set forth in the Map Act and assessment district statutes described below. Many local jurisdictions may have been utilizing small scale developer-property owners reimbursement agreements for a substantial period of time to effect the extension of utility lines — often without express statutory authorization or formal procedure.

The Map Act provides a second public improvements financing tool which runs to the benefit of the developer, but which localities may use as an in-

centive to entice new potential revenue generating developments such as industrial parks into its jurisdiction. Specifically, California Government Code Section 66462 provides that the local entity may permit a subdivider to defer and finance the completion of required subdivision improvements through the establishment of an assessment district. Unlike the traditional notion of an assessment district encompassing many properties, a district established as part of a subdivision process will often have only one affected property owner, the subdivider. This factor greatly facilitates the formation of the district.

Certain jurisdictions also permit the subdivider to enter into agreements which defer the subdivider's responsibility for installation of improvements not critically needed at the present time.

Assessment Districts

Although there are others, the primary statutory authority for assessment districts is as follows:

- Special Assessment Investigation, Limitation and Majority Protection Act of 1931 (Debt Limit Act), California Streets and Highway Code Sections 2800 et seq.;
- Improvement Act of 1911, California Streets and Highways Code Sections 5000 et seq.;
- Municipal Improvement Act of 1913, California Streets and Highways Code Sections 1000 et. seq.;
- Improvement Bond Act of 1915, California Streets and Highways Code Sections 8500 et seq.;
- State Subdivision Map Act, California Government Code Sections 66483 et. seq., which provide for designation of areas of benefit and the levy of fees upon the properties therein for the construction of various forms of public improvements.

Construction of public improvements may be financed from numerous different sources of revenue. If the benefit of the improvement is spread throughout a community, the source of revenue theoretically ought to be general taxation. If the benefit is related to the use of facility or service, then a fee or service charge is normally made. If the need for an improvement is generated by and the benefit flows to a property for which a land development or subdivision application has been filed with a locality, the responsibility and cost for constructing said improvement usually rests with the developer or subdivider. However, where special local benefits flow to an identifiable real property or properties, a special assessment or fees may be levied on the specially benefited properties under one of the above statutes. The theory is that the ". . . general public should not be required to pay for special benefits for the few, and the few specially benefited should not be subsidized by the general public." *Solvang Municipal Improvements District v. Board of Supervisors of the County of Santa Barbara* 112 CA 3d 545, 169 CR 391 (1980).

Special assessments are governed by relatively strict statutory procedural requirements and in amount must not exceed a particular piece of property's proportionate share of the cost of the public improvement as measured by its particular or special benefit. So limited, special assessments do not appear on the surface to provide an arena for bargaining between developers and public entities. Referring back to the discussion of the Subdivision Map Act above, however, one sees that an assessment district may provide a developer with a very valuable means to spread out, in space and time, the cost of major public improvements. As establishment of such districts or their use is discretionary with local public entities, the use of the assessment district process may readily enter into bargaining between developers and public entities. Moreover, with the consent of the affected jurisdictions and developers, assessment districts have reportedly been used to fund projects outside the limits of assessment laws.

Annexation Agreements

(California Government Code Sections 56000 et seq.; Sections 35000 et seq.; and Sections 54733 et seq.)

When owners or proposed developers of unincorporated territory apply for annexation to a city or special district, the local jurisdiction and developer may negotiate an annexation agreement. Such agreements have been known to provide, for example, that the landowner will install certain utilities or improvements in exchange for jurisdiction approval of annexation and a particular prezoning, or certain services. Such agreements have been upheld and enforced by the courts against the challenge that they are ultra vires, void and unenforceable for reasons to be discussed in Chapter 9, in the following cases:

Morrison Home Corporation v. City of Pleasanton 58 CA 3d 724, 130 CR 196 (1976); *Carruth v. City of Madera* 223 CA 2d 688, 43 CR 855 (1965); *Wright Div. v. City of Mountain View* 53 CA 3d 274, 125 CR 721 (1975); *M.J. Brock & Sons, Inc. v. City of Davis* 401 F. Supp. 354 (N.D. Cal. 1975).

California Environmental Quality Act

(California Public Resources Code Sections 21000 et seq. and 14 California Administrative Code Section 15000)

The environmental review process established by the California Environmental Quality Act (CEQA) has had a tremendous impact upon both the procedural form and the substance of the local planning and land development process. A required part of any application for annexation, development, or subdivision, the CEQA process is often the primary vehicle for defining discretionary conditions of project approval. The inevitable debate between a developer and local government over planning and environmental conditions of approval, however, has probably expanded more fully into true negotiation and bargaining with recent amendments to CEQA designed to streamline the process. In large part, these amendments encourage the use of what is now called the "Mitigated Negative Declaration."

In the early stages of project review, the staff of the public agency may inform the developer that if certain environmental mitigation measures are voluntarily and immediately incorporated into the project plan, the local agency will be able to issue a Negative Declaration on the project in lieu of requiring an often expensive, time-consuming, and risky Environmental Impact Report. There is obviously a high incentive for the developer to agree to the proposed mitigation measures. Reportedly becoming extremely popular, this procedure is significant in that the agreement reached regarding environmental mitigation measures is free of relatively rigid statutory standards governing proper conditions of Subdivision Map approval and frequently developed by public agency staff and the applicant with little scrutiny or input from the public or even elected officials. Coming early in the review process, there are high economic and risk-avoidance incentives for the developer to be especially cooperative. The CEQA process presents a clear avenue for local public agencies to negotiate and create terms whereby the developers can help overcome the fiscal constraints of recent years in exchange for an expedited project review and approval.

Specific Plans

(California Government Code Sections 65450-65553)

Specific Plans generally focus on a subgeographic area within a local jurisdiction and are designed to establish all the detailed regulations, conditions, programs, and proposed legislation necessary for implementation of the local General Plan in that area.

In the past, the Specific Plan was an infrequently used tool for the implementation of the General Plan because local jurisdictions usually lacked the necessary sophisticated staff or resources for consultant services. Thus, jurisdictions sometimes request that an individual project applicant prepare or fund the preparation of a Specific Plan which will encompass the applicant's project.

Because of the specificity and sense of long term assurance provided by Specific Plans, applicants for large scale development may be willing to accept financial responsibility for the plan despite the significant "front end" investments in planning, architectural, and engineering fees that are at risk pending project approval.

In order to assist and encourage greater use of Specific Plans, the Legislature in 1979 adopted California Government Code Section 65453, which expressly authorizes local jurisdictions to transfer the cost of developing Specific Plans to the owners of all benefited private property. This is accomplished by imposing a special fee upon persons in the plan area subsequently seeking governmental land use approvals which are required to be in conformity with the adopted Specific Plan. One example of a Specific Plan prepared under the approach set forth in Government Code Section 65453 is the Pear Tree Lane Specific Plan in the City of Napa.

California Coastal Act

(California Public Resources Code Sections 31000 et. seq.)

Much of the discussion above concerning trends in the local planning, environmental, and subdivision process is equally relevant to trends or opportunities for bargaining between the Coastal Commission and its staff with development project proponents. The Commission reportedly, however, has tended to standardize its policies, somewhat in the manner of the state legislation discussed above concerning density bonus incentives. Such an approach confines to a greater extent the potential scope of bargaining feasible, but on the other hand it provides for more uniformity in treatment of projects and probable public input into the standards.

Local Growth Management Programs and Building Permit Allocation Systems

Local growth management systems vary but they can generally be classified into two types: 1) controls based upon availability of public services; and 2) controls based on number, location, and mix of residential units or compliance with local inclusionary zoning ordinances. A carefully designed point system can encourage intense competition among developers to assume an ever-increasing share of the public improvement and service costs related — or unrelated — to their proposed development. Controls based on availability of services may force a developer to assume the full cost of extending services or improvements to his site if he wishes to develop in advance of the planned dates of service extension by the jurisdiction itself. A growth control program of this type was validated in the well known case of *Golden v. Planning Board of Ramapo* 30 N.Y.2d 359, 285 N.E.2d 291 (1972).

Zoning and Building Code Administration

(California Government Code Sections 65800 et seq., California Health and Safety Code Sections 17910-17995, and Local Ordinances)

The state planning and housing laws and the local zoning and building code administration process control the approval and issuance of building permits, use permits, variance, architectural plans, and condominium permits.

The principles governing dedications, conditions, and exactions imposed upon governmental approval of the many forms of planning and building permits are the same as those set forth in the discussions above of the subdivision and environmental review process (see generally, Longtin, *supra*, pp. 244-252). However, because of reported increases in the use of the Mitigated Negative Declaration in reviewing project applications (see discussion above), a subtle shift is occurring in traditional permit areas to a negotiating relationship between the jurisdiction and applicant, which may also free bargains from statutory constraints related to proper conditions of approval.

4

Types of Bargains

Just as the arenas in which bargaining between developers and jurisdictions can occur are multiple, so too are the types of bargains which can be reached. This chapter seeks to organize the bargaining taking place according to the structure of the agreements reached, that is, what the developer and the jurisdiction agree to do. In many cases, the jurisdiction's part of the bargain is granting the various approvals needed, although the jurisdiction can also undertake related public improvements or use its authority to create legal entities (e.g., assessment districts) or to issue debt at favorable terms to advance the project to completion.

To facilitate presentation of these often complex bargains, they are described from the perspective of the developer. Moreover, the term "developer" is used to designate the private sector side of these bargains, although the developer's successors in interest in the project or the project occupants may also be bound by the agreement reached. Unless otherwise stated, what the jurisdiction provides to the bargain are only needed approvals (e.g., acceptance of mitigation measures under CEQA, or approval of a subdivision map).

Complex projects often include more than one type of bargain. Bargaining also commonly occurs in more than one of the arenas described in the previous chapter. To simplify the presentation, the terms "bargain" or "agreement" are used interchangeably to describe what may be a variety of actual devices used to effectuate the agreement reached. One of the most complex tasks confronting the developer — often requiring the services of a team of project managers, engineers, and attorneys — is to mesh all the bargaining and approvals needed into a package in a timely fashion while retaining the prospect of profits.

Figure 4.2 offers a listing of 14 types of bargains. Each is then considered in turn, including a brief description of the general structure of bargain included. One or more examples are often provided for illustration.

Payments in Lieu of Taxes

A simple form of bargaining that arose after passage of the Jarvis-Gann Initiative requires the developer to pay to the jurisdiction an annual sum equivalent to the difference between property taxes actually received and those which would have been received had Proposition 13 not passed. This

Figure 4.1: Types of Bargains

1. Payments in lieu of taxes
2. Construction of public improvements in the project area
3. Lump sum payments from the developer to the jurisdiction, sometimes plausibly related to the project
4. Construction of public improvements with possible full or partial repayment from charges imposed upon other developers in the future
5. Construction of public improvements outside the project area
6. Construction of jurisdiction-desired capital improvements to gain points under a growth management plan
7. Joint public and private use of shared facilities constructed by the developer
8. Provision of services, reducing both capital and operating budgets of a jurisdiction
9. Maintenance and operation of public facilities or places
10. Conditions upon developer or project occupants which facilitate accomplishment of a jurisdiction's policies
11. Modification of project to meet public policy purposes
12. Acquisition of real property (unimproved or improved) by developer who transfers title to the jurisdiction or otherwise uses or disposes of it according to the directions of the jurisdiction
13. Sharing profits from the project with the jurisdiction
14. Private development of public property as a source of public sector revenue

type of agreement salvaged some in-process redevelopment projects financed by allocation of tax increments to a redevelopment authority.

An example is found in the City of Santa Monica, where a downtown shopping center project under planning for more than a decade was just coming to the point of signing of final agreements when Proposition 13 passed. To save the project, the developer agreed to pay the difference between post-Proposition 13 tax receipts and the tax revenues that would have been received had the pre-13 tax rates been applied to the assessed value of the project. These payments are to be halted if Proposition 13 is declared unconstitutional or otherwise becomes inoperative or upon retirement of the tax allocation bonds financing the public improvements required for the project.

Construction of Public Improvements in the Project Area

In addition to the uniformly required dedication requirements, the

developer and jurisdiction can agree that the developer construct additional public improvements in the project area. The request from the jurisdiction for such construction can arise from a general desire for their construction, but this type of bargaining appears to occur frequently in the context of environmental impact studies required by the California Environmental Quality Act (CEQA). Current CEQA procedures require the broadest ranging analysis of project environmental impacts, well beyond the physical environment, to include such issues as traffic flows, impacts upon the available capital infrastructure of the jurisdictions serving the project (e.g., storm sewer systems, water supply, schools), and upon the revenues and expenditures of the permit issuing jurisdiction. When negative impacts are discerned, mitigating measures may be required as a condition of project approval, including the construction of capital improvements.

The Aliso Viejo development in Orange County, approved in 1979, provides an example. As part of a complex package negotiated between Orange County and the developer, a project further analyzed in the next chapter, the developer agreed to construct all internal arterial highways and bike trails (in addition to the normal dedication of streets) and libraries, fire stations, and parks.

Lump Sum Payments from the Developer to the Jurisdiction, Sometimes Plausibly Related to the Project

A conceptually simple type of bargain involves a lump sum payment from the developer to the permit-issuing jurisdiction. Such a payment is commonly required as a condition of project initiation or payments can be spread over some schedule. In most such cases, the payment is related to a specific capital project to subsequently be undertaken by the jurisdiction, and this improvement is also commonly plausibly related to the project. An example of a context making such a bargain attractive to the jurisdiction can arise where a project consumes a large increment of the available unused capacity of a water supply, sewage disposal, or storm drain system. As this brings the jurisdiction closer to making a "lumpy" investment to increase system capacity, the jurisdiction is attracted to extracting a payment that can assist in covering that future capital outlay. In at least one case, however, a lump sum payment was negotiated by a jurisdiction for other purposes.

Four examples illustrate this type of bargain. When Budweiser was seeking approval of the construction of a large brewery, the City of Fairfield received $13 million towards projected increases in the city sewage and waste treatment system. In the Aliso Viejo case, the developer made payments to the county for projected future additions to water supply and waste water infrastructure. In Napa County, a developer of additional residential units at a golf and tennis resort paid the county $160,000 to improve traffic at an intersection several miles from the project but plausibly impacted by the development. Finally, in another Fairfield example, the city, acting as a redevelopment authority, assembled land for a regional shopping center, then

sold that land to the developer at a price $1 million higher than its cost. Proceeds were used to purchase an additional 70 acres on the fringes of the project area, which the city will release for development controlled by its plans intended to make the uses of those parcels supportive of the city policies. The Fairfield case, an innovative and complex bargain, is examined in more detail in the next chapter.

Public Improvements Constructed with Repayment from Charges Upon Later Development

Another type of bargain entails the developer constructing (bearing full cost) capital improvements larger or more extensive than required for his project alone, with a portion of those costs to be recouped by charges levied on subsequent development using the infrastructure. In this type of bargain, the developer is, in essence, a lender to the jurisdiction. The developer may have different varieties of recourse of payment: no, partial, or full recourse from the jurisdiction if payment resulting from development does not occur by some specified date, or ability to compel payment from the affected property owners upon transfer of title to the property or by some specified date. Interest on the funds so expended may accrue, being added to the charge levied on beneficially impacted parcels. An assessment district may be created to provide a formal mechanism for enforcing this type of bargain.

As an example, a small rural Northern California city required a developer to install a storm drain system much larger than needed for his project to accommodate possible future development of other parcels in the vicinity. Interest accrues on the additional expenditure required ($100,000), which has been apportioned among the related parcels according to a calculation of benefit received. Owners of these other parcels are to pay their proportionate assessments, plus accrued interest, as each parcel is developed. The developer has no recourse to the city for these funds, nor does any time limit for repayment exist.

Construction of Jurisdiction-Desired Capital Improvements To Gain Points Under a Growth Management Plan

Some jurisdictions control growth by allocation of a predetermined number of building permits under a system in which applicants are given points under a growth management plan according to attributes of the proposed project, and building permits are allocated in descending order or point totals. Under the "Ramapo" plan, developers may acquire points by agreeing to construct capital improvements desired by the permit allocating jurisdiction (Longtin, 160-161).

As an example of an extreme form of such a process, developers literally bid against each other in open session at a Napa City Council session, agree-

ing to project design features and capital improvements in efforts to increase point totals enough to obtain building permits. That growth control system has now been abandoned, but other jurisdictions continue to use point-based allocation systems.

Construction of Public Improvements Outside the Project Area

Just as jurisdictions and developers may reach an agreement concerning construction of public improvements within the project area, they may do so for improvements outside of the project area. In some cases, these improvements would be related to the project (e.g., improving an arterial intersection feeding the project although at some distance), but they need not be so related.

Joint Public and Private Use of Shared Facilities Constructed by the Developer

Another form of bargaining results in developer construction of facilities which have shared purposes, offering both public and private uses. In these cases, operation and maintenance may also be shared or be the sole responsibility of the developer or the jurisdiction.

Parking facilities for projects along the Santa Monica coast provide an example. Developers of coastal properties were required to provide more parking spaces than ordinarily required and then to provide parking to the public with the objective of improving access to the beach.

Provision of Services, Reducing Both Capital and Operating Budgets of a Jurisdiction

Yet another way that the developer can assist a jurisdiction in meeting its needs for capital investment is to provide a service commonly provided by the jurisdiction, thereby reducing both public operating and capital budgets. This option is available in larger developments of all kinds, though apparently more common in industrial and residential projects.

Common examples in commercial and industrial projects include private provision of security forces and, less frequently, fire-fighting services. A few residential projects provide private security services, ranging all the way from patrols to guards at points of limited access to the project. These private security forces relate to public police forces in several different ways (Dart, 1980). Planned communities, such as Leisure World, carry this much further, providing not only security services but also paramedics and recrea-

tion services. Homeowners' associations may also arrange for the private provision of services commonly provided by local government.

Maintenance and Operation of Public Facilities and Places

Only marginally different from the previous type are cases where the developer maintains or operates public facilities and places. In many cases this will not directly provide capital infrastructure nor reduce the need for public investment in capital goods, as it has the character more of on-going, operating expense. But this type of bargain usually arises only in the context of the sort of substantial developments being discussed here and may be one of the elements that allows a successful bargain to be reached.

An example of such an agreement would be private operation and maintenance of all of the public and open spaces associated with a shopping center, even though some had been dedicated over to the local jurisdiction.

Conditions upon Developers or Project Occupant Activities Which Facilitate Accomplishment of a Jurisdiction's Policies

An agreement between a developer and a jurisdiction may impose conditions upon the developer and project occupants which facilitate the accomplishment of a jurisdiction's policies. In some instances, modification of the project occurs, a case examined in the next type of bargain considered. In the present instance, the project itself is not modified, but the activities of the developer or project occupants are constrained toward achievement of a public purpose.

Returning to Santa Monica Place, the downtown shopping center, the developer leased parking for its employees from the city parking district authority. This provided revenue to assist in the retirement of bonds issued to construct parking structures serving not only the new shopping center but an older adjacent shopping mall.

Modification of Project To Meet Public Policy Objectives

As suggested in discussion of the previous type, in some cases, the developer may modify the project to meet public policy objectives. Indeed, this has occurred quite frequently with proposed residential projects, which were commonly reduced in scope during the 1970's as a consequence of the environmental impact reviews required under CEQA (Frieden, 1978). For present purposes, however, the project modifications of interest are those that substitute for, or otherwise reduce the need for, public sector capital investment.

An example is found in bargaining over the inclusion of housing to be provided (for purchase or rental) to individuals and households of low and moderate income in residential projects. While the California Coastal Commission and some jurisdictions have established policies requiring specific ratios of such housing (inclusionary zoning policies), bargaining still occurs. In the Aliso Viejo case, for example, the developer agreed to provide 5,000 units of "affordable" housing. In Rancho Carmel, 10% of the housing is to be "affordable." Rancho Carmel, a large mixed-use project developed by Nathan Shapell in northern San Diego County, is described in the next chapter.

Acquisition of Real Property (improved or unimproved) by Developer Who Transfers Title to the Jurisdiction or Otherwise Uses or Disposes of it According to the Directions of the Jurisdiction

In some bargains, the developer acquires real property outside his project area and either transfers it to a jurisdiction or uses it in pursuit of a public objective.

The City of Santa Monica offers an example. There a developer purchased housing units outside the proposed project area to meet city and Coastal Commission concern for low and moderate income housing. Yountville, a small Northern California town, required a subdivider to acquire outside property to provide a preferred main access to the subdivision and to offer property outside the subdivision but owned by the subdivider to the city for the development of low and moderate income housing.

Sharing Profits from the Project with the Jurisdiction

The jurisdiction may bargain to share in the profits generated by a development project. While the jurisdiction could commit the resulting revenue stream to purposes, including capital construction, related to the project, this was not done in two examples discussed here. Given the fiscal strains upon local jurisdictions and the uncertainties concerning long term revenues derived from any proposed project because of the willingness and capability of the governor and Legislature to move tax base around among local jurisdictions, the possibility of obtaining substantial non-tax revenues for general use is alluring to these governments.

Three examples illustrate the possibilities. The City of Napa will receive a percentage (10%) of the overage rents received when gross sales exceed a base figure on satellite shops in a shopping center project which has been approved but not yet constructed. This contract clause is expected to yield less than $10,000 annually and expires in 30 years. As is discussed more

fully in the next chapter, the city also receives 10% of the proceeds from any refinancing of the project.

The City of Fairfield and Ernest Hahn, developer of the regional shopping center discussed previously, have entered into an agreement providing the city 10% of any net annual cash flow between $250,000 and $500,000 and 15% of net annual cash flow in excess of $500,000. The city participates in similar proportion in any transaction by which the developer receives proceeds from the project. This contract is not limited to any time period.

In a third, non-local government example, the state is leasing some state-owned resource areas to energy producing corporations on profit sharing formulas. And Cal-Trans is entering into long-term leases with developers for the use of "excess" lands. In a case in San Diego, a restaurant development will make lease payments based upon a percentage of revenues.

Private Development of Public Property as a Source of Public Sector Revenue

Where a jurisdiction owns property or controls a resource, it may turn to the private sector for development of the property or resource as a source of revenue. These revenues can be used for any legitimate purpose, but in at least two cases are tied to capital expenditures.

Santa Clara County is developing a plan to use revenues from the disposition or development of public properties to generate revenue for planned construction of a criminal justice center project estimated to cost $70 million to $100 million. The State of California leases state-owned tidelands for oil development on the basis of profit-sharing in the revenues derived, historically earmarking the revenues received for a variety of capital construction activities (e.g., public higher education, parks and recreation, transportation, school buildings).

5

Case Studies

This chapter analyzes several cases in greater depth than in the previous chapter. Even here the intention is not to give full details on any case (the legal documents effectuating the agreements described here can run to several hundred pages in length) but to give the reader enough information to provide an appreciation of the potential of this strategy for providing the capital infrastructure needed for growth in California. The cases discussed are among the more complex that could be chosen. While not representative of all the types of bargains enumerated in the previous chapter, many of those types are described. So too do a number of legal bases come into play, although redevelopment projects are over-represented as they often involve more complex bargains and thereby illustrate a richer variety of types of agreements within a single case.

Each case is presented in turn. The first three are already somewhat familiar, having been briefly described in the prior chapters. They involve redevelopment projects in the cities of Santa Monica, Napa, and Fairfield. The fourth case is the Aliso Viejo project, a very large subdivision in Orange County. Rancho Carmel, a recently approved mixed-use project in San Diego, is the fifth case. The use of public lands to raise revenues by Santa Clara County is the sixth case.

Santa Monica: A Lost-Tax-Revenue-Replacement Case

Proposition 13 passed as the City of Santa Monica was in final negotiations with developers of a downtown renewal project (Santa Monica Place, a shopping center) with a total estimated cost of $18,000,000. The project was important to the city, culminating a redevelopment process that had been initiated nearly two decades previously but which had floundered several times (O'Toole, 1977). Tax increment-backed revenue bonds were to provide financing for the city's activities in support of the development, including street reorientation, land assembly, and provision of parking. Rouse and Hahn were general partners in the development. Robinson's and the Broadway were both to build department stores in the project, with the usual provisions made for satellite shops and restaurants. The annual tax increment revenue lost as a result of passage of the Jarvis-Gann Initiative totaled $650,000, threatening the city's ability to meet its obligations, and thus the whole project.

The agreement reached among the city, general partners, and two department stores calls for payments to the city of an amount approximately equal to the tax increment lost upon passage of Proposition 13, to be paid annually until the bonds are amortized. Provisions are made to reduce or increase the payments under a number of contingencies (City of Santa Monica, 1978). While the city is advantaged by this agreement in that it ensures continuation of a desired project (which will, itself, generate sales tax revenues and, hopefully, stimulate additional development in the area), the developers and department stores are also advantaged in being able to complete what they anticipate will be a profitable project. Also, they obtained a payment schedule which will probably result in annual payments less than those projected for pre-Proposition 13 taxes and which will end upon retirement of the bonds, whereas taxes would have continued in perpetuity.

A feature of this project agreed to before passage of Proposition 13 was the leasing of parking spaces for employees of Santa Monica Place in city Parking Authority structures. These structures primarily serve an adjacent, older shopping mall whose merchants were anxious about competition from Santa Monica Place. The city preferred this arrangement because it reduced the likelihood of employees searching for already congested on-street parking and helped amortize the revenue bonds which had financed construction of the parking structures. An advantage accruing to the developers was ability to devote a smaller percentage of the total square footage of the project to parking.

Napa: Non-Tax Revenues as Part of a Complex Financing Package

The Napa case also involves a long-planned downtown renewal project threatened by the reduction in tax increment funds caused by Proposition 13. In this case, that reduction was doubly important since the proposed project was financed partially by uncommitted increment from a previous, adjacent redevelopment project and partially from the tax increment anticipated from this second phase project. The two revenue reductions totaled nearly $800,000 annually, approximately what the city originally anticipated as annual bond amortization costs of the estimated $7 million it was to spend for constructing two parking garages and reorientating streets. In addition, the city had assembled the project area land at a cost of about $800,000 and was to transfer it to the developer for $600,000, the value determined for such a large parcel through the "reuse appraisal" process often used in redevelopment projects.

As in Santa Monica, the basic concept was the standard department store anchor (here a single Rosenberg's store) plus satellite shops. In the agreement reached, the developer is committed to build a 40,000 square foot building for the department store and no fewer than 50,000 square feet of satellite shops, at an estimated total cost of $12 million. The city has a small annual participation arrangement in the project, receiving 10% of the "overage" rents on the satellite shops (with a provision to limit annual base rent increases to the Consumer Price Increase, intended to protect the ci-

ty's interest through increasing the likelihood of overages). This feature of the contract between city and developer is anticipated to yield less than $10,000 annually and is limited to 30 years.

More provision under which the city is to receive 10% of the proceeds of any refinancing (or — if the refinancing lender will not make payments to the city — an alternative buyout from the developer of 10% of a "calculated"worth established as an 8.5% cap rate on the last three year's average income from the project, estimated to yield approximately $100,000 in the early years of the contract). Subsequent refinancings within the 30 year term of the agreement are subject to the same provision, which is a covenant upon the deed transferring the land.

The City of Napa is piecing together the revenue it needs to meet annual bond costs that increased interest rates have inflated to approximately $1.1 million annually. The remaining tax increment funds from the first phase plus the increment to be generated by the second phase will be committed. Instead of being abolished, the now low parking fees (five cents per hour), will be tripled in the downtown area with an anticipated yield of $250,000 annually. Much of the increased sales tax revenues and business license fees generated by the development will go to bond retirement instead of on-going service provision, either in the project area or elsewhere in the city. The city also expects the project to enhance the value of several smaller parcels scattered on the edges of this development which it owns (totalling under four acres), and may ground lease them to developers, which would offer opportunities for greater participation.

This project has been delayed because of high interest rates, but may be initiated in 1982.

Fairfield: The City as Entrepreneur

Ernest Hahn, Inc., one of the developers in the Santa Monica case, is also the developer in the Fairfield case. The project is a regional shopping center (Solano Mall) on a 26 acre site about half a mile off Interstate 80, between San Francisco and Sacramento. As in the two previous cases, the city acquired the land as part of a redevelopment project. In addition to land assembly, it undertook public improvements to improve access to the site, to solve drainage problems in the area, and to relocate an elementary school adjacent to the projected site to a more suitable location. Included is construction of a freeway interchange without any state or federal funds.

The city generates revenues from the project in several ways, including an aggressive use of non-tax strategies. The tax revenues include the property tax increment, sales taxes, and business license fees that will be generated by the shopping center. In addition, a special assessment district encompassing the project area and adjacent areas is to be formed to assist in financing public improvements through issuance of bonds. The developer is committed to paying up to $350,000 annually in such assessments for a period not to exceed 25 years.

Non-tax revenues are substantial. The purchase price paid by the

developer for the parcel netted the city in excess of $1 million more than its land acquisition costs. Receipt of these funds facilitated the city's program of land purchase in the redevelopment project area where it now owns more than 70 acres planned for future development. Additionally, the city is to receive from the developer 10% of any net annual cash flow between $250,000 and $500,000 and 15% of net annual cash flow in excess of $500,000. The city participates in the same ratio in any transaction through which the developer receives proceeds from the property (e.g., refinancing, sale, or leaseback). This participation agreement "runs with land" and binds any future holder of the developer's present interest in the property. It has no termination date, so will be reduced only if Proposition 13 is somehow repealed or ruled invalid and the city actually receives ad valorem property tax increment revenues.

Aliso Viejo: Achieving Multiple Policy Objectives in a Large Residential Development

Th Aliso Viejo project, involving construction of 20,000 new homes in one of the most desirable areas of Orange County, illustrates how a jurisdiction can achieve multiple policy objectives in a large residential development. Unlike the three previous cases, non-tax revenues will not be generated. However, extensive infrastructure ordinarily provided by the local jurisdiction will be constructed by the developer, an extension of the normal practice of a developer constructing streets and curbs then dedicating them to the local government. In addition, Orange County used the broad powers possessed by California local governments under the Subdivision Map Act (as recodified in 1974) to pursue energy conservation, open space preservation, and affordable housing policy objectives.

In 1979, at least two and one half years after the planning process for Aliso Viejo had begun, the project plan came before the County Board of Supervisors for approval. The ensuing negotiations evolved to include far more than the construction of the homes. The plan ultimately approved include the following additional features:

> a 3,400 acre greenbelt; 5,000 units of affordable housing; company-provided construction of all internal arterial highways, roads, and bike trails; payment by the company for the construction of major water and wastewater infrastructure prior to actual need; and initial installations of capital facilities, including library facilities, fire stations, and parks by the company, at no cost to the county (Raub, 1979:11-18).

Extensive negotiation was required to achieve the ultimate plan. The county had bargaining leverage, but had to do more than demand concessions from the developer. In return for the commitment to build affordable housing, for example, the county increased allowable project density, thus increasing the total number of houses that can be built. Spurred by the county revenue reduction caused by Proposition 13, both the county and the

developer approached the negotiations with more flexibility and care than has historically been the case. Litigation against Orange County disputing the adequacy of its housing element also encouraged careful bargaining.

The Aliso Viejo Company projects that average annual county revenues will exceed average annual county costs by $2.83 million to $4.47 million upon project completion. The company's analyses also conclude that the ultimate plan has lowered county costs while increasing county revenues from those that would have been experienced had development proceeded under the county's existing General Plan (Raub, 1979:14).

Rancho Carmel: Providing Capital Infrastructure for a Large Mixed-Use Project

In late 1981, the San Diego City Council approved a plan for developer financing of the capital infrastructure for Rancho Carmel. The project to be completed during the next 15 years is a large mixed-use development. Situated on a parcel of nearly 1,500 acres of northern San Diego County, the project is expected to cost about $1 billion, and to include more than 7,000 dwelling units, a 1.2 million square-foot shopping center and 100 acres of light industry.

The developer, Shapell Industries, is to provide 33 separately identified capital-infrastructure projects, at a total cost of $57.5 million (Public Affairs Consultants, 1981). Included are arterial roads, freeway overpasses and interchanges, sewer mains, water system pumping stations and reservoir, parks, a library, a completely equipped fire station, and park and ride facilities. In addition, 211 acres of open space are to be dedicated to the city.

Moreover, fees will be paid for specific purposes. Approximately $370 per residential unit will be paid for community parks and recreation centers. Negotiations are under way between the developer and the Poway Unified School District to set fees that will cover construction of two new elementary schools and expansion of junior and senior high schools. These fees are estimated to be approximately $25 million (Shaw, 1981).

Thus, the total developer funding for capital infrastructure historically borne by the public sector will approximate $85 million in this project: $57.5 million in capital improvements, $2.6 million in park and recreation fees, and $25 million in fees for schools. In addition, open space, and the traditional internal streets, roads and water and sewer systems will be dedicated over to the city.

In this case, the developer and the jurisdiction explicitly rejected the use of assessment districts to finance the needed capital infrastructure. This was reasonable given single ownership of the land to be developed. In two nearby areas, the City of San Diego is proposing using "facilities assessment" districts plus subdivision and park fees to finance capital infrastructure because the land is held by multiple owners (Shaw, 1981).

As in Aliso Viejo, the jurisdiction also pursued non-fiscal policy objectives. Ten percent of the housing units in Rancho Carmel are to be

"affordable." Moreover, the construction of residences is to be phased with the growth in employment opportunities offered by firms locating in the project in an effort to encourage a "self-contained" community characterized by a population which both lives and works in Rancho Carmel.

Santa Clara County: Use of Public Lands To Generate Revenues

The County of Santa Clara is seeking to sell or lease county-owned land to finance a $70 million to $100 million improvement of its jails. In this case, the jurisdiction has a specific need which it plans to meet through disposition of an asset.

Following receipt of a consultant's report analyzing the need for corrections facilities for adults, the county apparently decided that it could not fund the proposed projects from tax revenues. Several months after receipt of that analysis, the county solicited bids from financial consultants to analyze how it might derive the needed revenues from sale or lease of county-owned parcels. That analysis is now under way, so it is not yet known if the county will achieve its objective.

Several other jurisdictions and at least one state agency have explored or undertaken similar joint ventures for development of publicly owned land. Included are the Bay Area Rapid Transit District, the City of Palo Alto, Cal-Trans, and the Port of Oakland. State officials urged the Los Angeles Unified School District to dispose of excess property to help meet its needs for revenues.

6

Role Perspectives in Bargaining

Prognoses as to the future of bargaining must be based in part on some understanding of the various participants involved in or significantly impacted by the land development process. Six such groups of participants may be identified by role:

(1) developers

(2) officials of local jurisdictions

(3) financial intermediaries (such as bond underwriters; all those who provide access to debt)

(4) land owners (of developable land)

(5) citizens (of the local jurisdiction; especially important are the "neighbors" of a proposed development)

(6) state government

Each role may be analyzed in terms of the goals held by individuals occupying that role and by the incentives and constraints they confront. In substantial part, the incentives and constraints are found in the procedures for interactions among roles. The behaviors of the individuals who occupy the various roles are expected to reflect their goals and the incentives and constaints they confront.

Not all roles are equivalent in the land development process. In the bargaining of immediate concern here, for example, it may be said that developers and local officials have central roles while the other four roles are facilitative and constraining. This distinction recognizes that developers and local governments are the principal actors whose interactions are required for bargaining to occur. But the context in which those who occupy these two central roles bargain is set by the other four roles. And these four are not indifferent to the bargaining which takes place. They also seek to achieve their goals through this process. The next chapter develops a behavioral model of the interactions of developers and local jurisdictions around different types of bargains.

Table 6.1 provides summary information on how each role relates to bargaining. For each, typical goals and incentive structures and constraints faced are identified. As will be seen, perspectives on bargaining attributed to the various roles intersect at several points but they are by no means

Table 6.1: Key Attributes of Six Roles Relevant to Bargaining

Role	Typical Goals	Incentive Structure Faced	Constraints Faced
Developer	profit, risk avoidance	to succeed, must achieve joint actions of other actors to support project	laws, policies, and politics are unstable; must take the lead
Local Officials	desired land uses, balance revenues & expenditures, predictability, in some cases continuation in office	to achieve the preferred future, must rely upon developers; must also maintain a stable political system; in some cases campaign contributions needed.	laws, policies, and politics are unstable
Financial Intermediaries	profits, risk avoidance, marketable debt	must receive equivalent returns from development-oriented debt as from alternative invest ments	limited capacity; legal restrictions; economic instability

Land Owners	profits, risk avoidance	to realize value of land, it must be developed	laws, policies, politics, and economic demand change; land is immobile
Citizens	desired type of land use, control of government, beneficial tax-expenditure ratio	development shapes future of jurisdiction, aesthetically, economically, and politically, but change and choice have risks	to act politically requires resources
State Government	predictability, protection of selected state policy objectives	frequent pressure from various actors to define rules of land development in ways that respond to their problems	must achieve many policy objectives through other actors, especially local jurisdictions

congruent. Indeed, one issue emerging from this exercise is how enough commonality of interest may be identified to allow bargaining, or any land development, for that matter, to take place.

One clue as to how this issue is resolved is that each of the roles ordinarily has some interest in using land development decisions to achieve a desired future state of affairs. Developers want to complete a project because their economic livelihood depends on doing so. Officials of local jurisdictions hope to use development and to achieve the sort of locale they believe ideal (such as aesthetically pleasing, economically strong, and so on), aspirations shared in kind if not in specifics by the citizens of the jurisdiction. In some cases, elected officials hope to use development to assist their continuation in office.

Participants have an interest in development, and in bargaining as a part of the development process, as a way of achieving quite disparate objectives. This suggests that policy making concerning land use and bargaining will often be conflictive. It also suggests that discourse among the participants will often sound cacophonous. Participants will not only pursue different goals, they will virtually speak different languages, perceiving different opportunities and problems in any choice situation. Examination of each of the roles suggests how this discord and conflict arises among actors whose preferred future can only be realized through development which requires either their active joint effort or at least acceptance.

Conceptually, the *developers'* role is easiest to understand. It is also difficult to perform well. Developers seek profits, and although the taking of risk is one rationale for their existence (and justification for profits), developers seek to minimize risk when possible. To succeed, to complete projects profitably, they must somehow elicit active support or passive acceptance from all other actors. Rarely do they win from conflict with any other participant. Other participants can too easily block a project or delay and modify it to such an extent that profitability is lost. The constraints faced by the developer include laws, policies, and politics which change in ways largely beyond the control of the developer. A further constraint developers face is the need ordinarily to take the lead in pushing for project completion. Taking the lead implies assuming financial and political risks. Moreover, being highly visible and lead, the developer's role is the object of much of the conflict and discordant language attendant to development and bargaining.

Local officials, both elected and appointed, formally establish policy and must be bargained with by developers. A local jurisdiction's goals, as expressed by public officials, typically include a desired pattern (and timing) of land uses, a desire to balance revenue produced and expenditures required (both overall and, frequently, for each specific proposed project), and a strong desire for predictability. Public officials also have an interest in continuing in office. Elected officials need campaign contributions and the approval of a plurality of those voting when they stand for election. Appointed officials need the support of the jurisdiction's elected officials to continue their activities and commonly require the support of the citizenry to be effective in their jobs.

To achieve their land use objectives local officials must (ordinarily) rely upon developers' actions. In jurisdictions choosing not to grow but to maintain existing land uses, developers are less critical to achieving the desired future of the jurisdiction. But where change is desired, the developer is most commonly the direct agent for achieving that change and local government officials seek to achieve their objectives by directing the actions of developers. Theoretically, although difficult politically, jurisdictions could act more directly, using their powers of eminent domain to acquire land and then acting as developer to achieve the desired uses.

The constraints on local officials are much the same as on developers. However, officials usually need not take the lead in pursuing completion of specific projects. They must, however, if they are not to abrogate the role, take the lead in defining the policy parameters under which development occurs.

Both jurisdictions and developers are commonly dependent upon debt financing for capital improvements required for new development. Both turn to *financial intermediaries,* such as bond underwriters, commercial banks, or investment bankers, to arrange this debt. We have already seen that the traditional mechanism of public debt, the general obligation bond, is now of very limited use to California local governments although the state can still use this instrument. General obligation bonds are no longer a viable debt instrument for California local governments because Proposition 13 prohibits increase of property tax rates above 1% of market value with an exception related to pre-Proposition 13 voter-approved debt, making the traditional "full faith and credit" pledge meaningless.

This situation illustrates one goal of financial intermediaries: They must have marketable debt or they are out of business, as they have nothing to place with the ultimate purchasers of bonds and notes. To be marketable, municipal debt issues must have yields commensurate with alternative investments and acceptable risks. For general obligation bonds, the revenue raising capacity of the issuing jurisdiction has been the key to defining risk. For revenue bonds, the risk assessment is made upon the probability of the projected revenue stream being realized. For assessment-based bonds, risk is ordinarily judged to be acceptable if the debt issue is a modest fraction of the total project cost and recourse is available against real property in the project, the sale of which would discharge the debt.

The financial markets are constrained by a variety of legal restrictions, such as the Glass-Steagall Act, which define permissable activities for various kinds of institutions. The economic instability of the past decade has unsettled traditional patterns. In response to uncertainties about inflation, and hence about desirable long-term interest yields, short-term issues have grown in popularity with both jurisdictions which issue debt and purchasers. Some new debt instruments are being developed, such as medium-term bonds with repurchase guaranteed by the underwriting institution. But such a guarantee is a contingent liability against the reserves of that institution, which must be cautious lest its reserve requirements be violated or the bond rating houses judge *its* own debt more risky, lowering the rating given for that debt.

Land owners are in a relatively straight forward role. They seek profits and wish to avoid risk. Their uncertainties are major, including not only how changing economic conditions may affect the value of their land, but also how changes in laws, policies, and politics can also reduce or increase parcel value. The most distinctive feature of the land owner role is that land is immobile. It is immutably in one location and must (with the rare exception of transferrable development rights) be developed there to achieve its full value. Although immobile, "land" is not in fixed supply. Changes in allowable densities and uses change the quality and types of parcels available for development. Chapter 8, which analyzes the likely impacts of increased bargaining, shows how the fact that land is immobile makes land owners the most probable ultimate, eventual payers of capital costs shifted from the jurisdiction to developers.

Citizens are a more complex lot. The reasons for their complex role are easy to discern. First, there are simply more citizens filling this singular "role" than for any other category of participants. This has several consequences, of which the two most important are that citizens rarely speak with a single voice and that communication with, or mobilization of, any group of citizens requires resources.

Granted the diversity of values and objectives held by citizens, there are some defining attributes to the role. One is that to citizens the land development process is critically important but very risky and almost alien in character. It is critical because it shapes the future of their jurisdiction economically, aesthetically, and politically. Whether the objective held is no growth, creation of a bedroom suburb, affordable housing, or economic growth, the development process is key.

Development is risky because it is hard for citizens to shape effectively and the choices made have consequences which endure for decades or generations. These two features of risk provide part of the explanation of why many citizens find the development process alien in character, so this issue may also be brought into this discussion.

There are several reasons why citizens typically find the development process hard to shape effectively. One reason has already been suggested: because there are many citizens their preferences will often conflict. Some citizens are likely to feel themselves losers, regardless of what policy is adopted. Over time, citizens may sort themselves out into jurisdictions whose land use policies accord with their preferences and economic circumstances (Tiebout, 1956), but this may be an imperfect process. Probably more importantly, many citizens will not commit the personal resources (mostly of time) to become knowledgeable and effective participants in the land use process. So they can easily feel excluded or ignored.

One reason the process is alien is that it is characterized by highly developed technical and legal processes. Citizens are forever confronting the need to understand a myriad of often conflicting technical and legal constraints.

A more abstract, but powerful, reason that citizens find the development process hard to shape and often alienating lies in the value conflicts alter-

natively illuminated and obscured in the professional languages which must be used in the development process. Citizens are not alone in finding this core feature of the process troublesome and even alienating: so too do local officials and developers. It is not possible (legally) to make land use decisions in California on the basis of simple preference statements. No city council nor county board of supervisors can simply say: "We want this project, it is approved by our vote." Instead, policy discourse concerning land use is restricted to the language legitimized by general plan, by mandatory elements to that plan (such as traffic, open space, or housing), by environmental impact statements, by Subdivision Map Act, by Municipal Organization Act, and by Knox-Nisbet's Local Agency Formation Commissions.

Cochran (1980) characterizes this phenomenon of limiting language as the creation of "motive talks," socially legitimized forms of expressing more complex, and even wholly different, values. Examples may illustrate the concept. A landowner who does not want an adjoining parcel developed (perhaps liking the view or lack of neighbors) does not voice these motives when opposing proposed development, but speaks instead of the need for open space, or of capacities of schools, streets, water systems, or sewers. Similarly, if the proposed project were desired because it increased the value of the parcel of our hypothetical landowner (perhaps by signaling a change in zoning to higher densities or because water and sewage lines have to be extended past the landowner's parcel to reach the proposed project), the language used to support the project would not mention these windfalls but would talk of providing needed additional revenues, housing, or employment to the jurisdiction.

Most participants in the land use policy process know that the language used does not accurately reflect the motives of those participating. Far from being reassuring, knowledge that language and motives are often unrelated is a cause of anxiety and alienation to the participants. At least our observation and discussions with individuals who participate in these processes leads to this conclusion.

Moreover, the language used has real impact. It is a cause for unease to the participants not only because it is "artificial" and they have always to search for other motives, but also because it is critical to the outcome of the process. This is a consequence of the language being based on the various legal procedures which control land use. To argue that an undeveloped parcel should be reserved for open space has different meaning when the jurisdiction has an open space element to its general plan which commits it to preserving a certain amount of open space than the same argument has in the absence of such a document. Similarly, to label an effect of development an "environmental impact" has important meaning, and to further label such an impact as an "unmitigated impact" has specific legal implications.

While these "normal" land development processes are intimidating and alienating enough to most citizens (and many public officials and developers), bargaining of the sort which is now occurring poses even further difficulties. One reason for this is that yet additional language and more professional expertise is added to the process. By and large, this is the language and ex-

pertise of development financing and investment banking. Under the old system, the developer primarily handled these issues, although public officials often had knowledge of these facts of the proposed projects they were considering. Under bargaining, these issues become much more central to the policy process. In some instances, these issues provide constraints for public action. In situations where the jurisdiction is an equity partner, such as Fairfield, a continuing, detailed knowledge of the financial dimensions of a project is required.

Moreover, bargaining usually takes place initially between the developer and the professional staff of the jurisdiction. As it progresses, elected officials are brought into the process, often informally. By the time the proposed project reaches the stage of formal consideration and public visibility, much of the bargaining has already occurred. Options have been considered; some have been rejected. Trade-offs among project features, project financing, and the policy objectives of the jurisdiction have been made. A division of responsibility between the jurisdiction and developer for the provision of needed capital infrastructure has been made. Ordinarily, those involved feel psychologically committed to the package.

Thus, bargaining can easily accentuate citizen unease with land development decision making by introducing new issues and by completing much of the process before citizens are even aware that a proposal has been made. In addition, the more explicit discussion of project financing that is common to bargaining can increase citizen fears that improprieties are occurring. In some cases, the fear is of old-fashioned graft and corruption, in which benefits received (perhaps personally, perhaps in the form of campaign contributions) influence votes. In other cases, the fear is more systemic: that desire for a project in which substantial capital costs are paid for by the developer, or in which the jurisdiction participates in project profits, will prove so appealing that the policy makers will not aggressively pursue the interests of the jurisdiction.

This fear is captured by the epithet "zoning for sale," language used by some of those who view bargaining as impure. The ideal image of policy making behind this slogan is that of the classic public interest model, in which public officials render judgments unsullied by competing interests, as if from Olympus. The public interest model is the basis upon which traditional planning and public administration were erected. The hoped-for virtues of this model are many, including equity in public policy (defined as treating like cases alike), efficiency in the use of society's resources, and the predictability found in stable decision rules. In our judgment, adherence to the public interest model is an unreasonable expectation in land use and development, a policy arena charcterized by sharp conflicts in images as to what the "public" interest might be. But the image is powerful and appealing to many individuals, so its effects must be accommodated.

After this extended discussion of the citizen role, that of the *state government* may be discussed much more briefly. State policies set most of the legal framework in which land development decisions occur. Because of this function, all others in the development process seek favorable policy decisions from the state. The main constraint upon the state, at least to date,

is that it must achieve the policy objectives it seeks (such as environmental protection, affordable housing, or economic development) indirectly, through the decisions of other participants in the process. In this regard, local jurisdictions have historically been particularly important to the state, which has sought to substantially influence their land use decisions by stipulating the procedures they must follow. A great emphasis has been placed upon the development of plans and upon seeking to constrain local policy making by those plans. Less attention, or even cognizance, has been given by state officials to the major impacts upon land use decisions of state laws that structure local government finance.

Taken as a whole, rather than role by role, this analysis suggests three final points. First, as will be further developed in the next chapter, the two central roles of developers and local jurisdictions are encouraged to develop a symbiotic relationship. They need each other to achieve their objectives (except for jurisdictions which choose to prohibit any growth or changes in land uses). Where the development process works well, jurisdictions and developers recognize this interdependence and nurture their interrelationship. This does not mean that the public sector is weak or a patsy for developers; it can mean that the public policy making capacity of the local jurisdiction is very great. However, the fact that the last sentence needs to be written, that one needs to argue for the possibility of a strong public sector working collaboratively with developers, is testimony to the strong suspicion of developers that exists in many California communities. We return to this issue in the last chapter of this volume.

A second point that emerges is that every participant prefers a predictable land development process. Each would apparently benefit from a system in which the rules were understood and stable. The present system is not predictable; legal, political, and economic factors have all changed dramatically since 1978 as a consequence of Proposition 13. They continue to change. Moreover, land use policy making in California was often unpredictable even before Proposition 13. Large scale development proposals have historically been considered on a case-by-case basis. The popularity of parcel-specific zoning procedures, through use permits and other devices, and the advent of environmental protection reviews lessened predictability through the 1970s. Bargaining is one response to this lack of predictability. It also provides opportunity for the affected parties to structure their vision of what the future development of their communities will be, to achieve at least local and project by project certainty.

Finally, it should be obvious that there is no direct representation of the next generation of Californians in the land development process. Their needs for housing, for employment, for a safe environment, and desired life styles, can only occur out of the interaction of the participants described above. In this regard, the sometimes maligned developers, pursuing their self-interest, serve as catalysts and as the vehicles by which the future is created. Local jurisdictions, and the state, play roles in this creation too, roles that we believe can and should be powerful and positive.

7

How Developers and Jurisdictions Approach Bargaining

Bargaining of the sort being analyzed here provides a large proportion of the capital needed to finance infrastructure needed for growth. Carried to its logical extreme, it could provide all of the funding needed. At that extreme, of course, only that development would occur which could justify such expenditures on the basis of the economics of the proposed project. As any external benefits would be difficult to capture and the full value of long-life assets might be difficult to fund with available financial instruments, a lower level of investment in capital infrastructure than is socially desirable is probable. This chapter and the next seek to explain the potential and consequences of increased use of bargaining between jurisdictions and developers, a trend we believe will occur for at least the next decade. The potential for expansion is considered in this chapter via analysis of what jurisdictions and developers seek as they bargain. The assumption is that if their needs can be better met by bargaining than by other alternatives, they are likely to use this approach more than the alternatives. What the consequences of increased bargaining might be is taken up in the next chapter.

In both chapters, analysis is hampered by ignorance of the present extent and forms of the bargaining. As Chapter 1 reported, this uncertainty concerning bargains is compounded by lack of information concerning the total amounts of private and public sector investment currently being made in California. A sensible starting point for this analysis would be compilation of past cost data and future cost estimates of capital infrastructure provided under each of the headings below:

Local Government Provided

- Debt Financed:
  - G.O. bonds
  - Revenue bonds
  - Tax Allocation bonds
- Capital Reserves Financed
- Intergovernmental Transfers Financed
  - Federal
  - State

Jointly Provided

Financed by developer fees, constructed by local jurisdictions
Bargained (all types of developer provisions)

Developer Provided

Dedications
Bargained (all types of developer provisions)

Even without numerical data, the list above conveys the most important argument to be made in this and the next chapter, bargaining of the type being analyzed here is only one of the instruments available to provide capital infrastructure and its use is immediately impacted by the attractiveness of alternatives. We predict increased bargaining because the alternatives are becoming less attractive. As comparative advantages and disadvantages shift, so too does the relative use of the alternative instruments, and bargaining could become less popular in the future. A more sophisticated analysis would model the trade-offs among these alternatives and the total amount and kind of development that occurs, which could in turn be related to population and economic growth.

For present purposes, given the limited amount of detailed information available concerning the financing of capital infrastructure required for growth, such a sophisticated analysis seems both difficult to complete and undesirable. Without better data, the analysis would be based upon laboriously assembled and justified estimates.

A more useful research strategy, given this stage of imperfect knowledge about these phenomena, is to explore the trade-offs among instruments. Moreover, that exploration is essentially verbal, not quantitative. We are not yet ready to construct the algorithm by which jurisdictions and developers can calculate the optimum mix of instruments for the provision of capital infrastructure. The immediately previous chapter described six roles involved in bargaining. Here the focus is on just two, developers and local government jurisdictions. These two are the key actors, whose behaviors constitute the bargaining of interest. As discussed in Chapter 6, the four other roles may be facilitating or constraining, but they are not central to the process.

To initiate this exploration, two matrices are presented. The first analyzes the alternative ways in which capital infrastructure may be provided according to the roles played by the jurisdiction or the developer. It is based upon an analytic framework previously found useful in the study of municipal service provision (Sonenblum, Kirlin, and Ries, 1977).

Accomplishment of any activity requires three elements: deciding what to do (planning), acquiring the needed resources (financing), and actually conducting the activity (producing). In a capital infrastructure example, decisions must be made about the location and design features of a storm drain system (planning), the needed resources must be acquired (which may be reduced to a common monetary denominator, to wit, financing), and the storm drain must actually be constructed (producing).

Importantly, the same actor need not perform all three tasks. To con-

tinue the same example, a city could undertake all three activities, planning the project, financing it from capital reserves, and building the storm drains. Alternatively, it could plan the system, establish an assessment district to obtain financing from benefited property owners, and construct the project. In a bargain of the sort described in Chapter 4, the city would plan the system, but have it financed and constructed by a developer who might receive partial reimbursement from other benefiting parcels. For the capital infrastructure projects under analysis here, it is useful to add two additional dimensions to this scheme: who owns (retains title), and who operates or maintains the project. This matrix of information is presented in Figure 7.1.

The second matrix (Figure 7.2) arrays the same possibilities concerning the provision of capital infrastructure as the first but analyzes each on two additional dimensions. Risk is the first dimension analyzed, subdivided into financial and political risk respectively for the developer and for the jurisdiction, a total of four risk categories. Both developers and jurisdictions are presumed to be risk averse, and thus to prefer less risky choices. Financial risks are defined as those which would reduce the value of the project to the developer, reduce revenues to the jurisdiction, or entail substantial unanticipated expenditures by either. Political risks to both parties are citizen reactions that result in substantial change, delay or the stopping of a desired project. For the jurisdiction, political risk can also include electoral conflict, possibly resulting in the defeat of incumbent office holders.

Financial and political risk are related. In particular, unexpected political conflict can cause financial reverses to the developer and even cause unexpected financial burden upon a jurisdiction. For this analysis, financial risks will be considered essentially the "normal" business risks such as those occasioned by miscalculation and changing market or financing conditions. Financial risks associated with political risk will be included in that category.

The second dimension included in the matrix presented in Figure 7.2 concerns the timing of any financial burden arising from a bargained agreement. Developers especially, but jurisdictions nearly to the same extent, should prefer longer-term cost impacts or costs incurred later in the development cycle to costs incurred early in that cycle. There are two reasons for this presumption, both mentioned previously. Being risk averse, both developers and jurisdictions prefer to delay costs until the project is absolutely certain to be completed and to meet projected income because until that time they cannot be certain of the final outcome of their efforts.

Developers are particularly sensitive to this issue. At the very earliest stages of a project, they are not even vested, running the risk of having the entire proposed project killed. Developers commonly consider themselves as having "completed" a project only when permanent financing has replaced any construction loans and debt service on that permanent financing and all other costs are firmly covered. Somewhat similarly, jurisdictions are not certain whether a project will be completed as they anticipated until it is; enough developments encounter financial or other difficulties to make these worries reasonable.

The second reason both developers and jurisdictions prefer to delay capital

Figure 7.1: Matrix of Developer-Jurisdiction Relationships in the Provision of Capital Infrastructure

Key: Jurisdiction = +; Developer = †; Joint Activity = §

Types of Bargains	Plans	Finances	Produces	Owns	Operates and Maintains
Payments in lieu of taxes	+	†	+	+	+
Public improvements in the project area	+	†	†	+	+
Lump sum payment	+	†	+	+	+
Construction and long-term financing of a public improvement, with possible repayment	+	†	†	§	+
Public improvements outside project area	+	†	†	+	+
Construction of public improvements to gain points under a growth management plan	+	†	†	+	+
Joint public and private use of shared facilities	§	†	†	†	†

Developer provision of shared services, reducing both capital and operating budgets of jurisdiction	§	†	†	†	†
Developer maintenance and operation of public facilities or places	§	†	§	+	†
Conditions upon developer activities which facilitate accomplishment of public purposes	+	†	†	†	†
Modification of project to meet public policy purposes	§	†	†	†	†
Acquisition of real property by developer for jurisdiction's purposes	+	†	§	§	§
Profit sharing with the jurisdiction	§	†	†	†	†
Development of public property or resources to provide revenues to the jurisdiction	§	†	†	§	†

Figure 7.2: Matrix of Developer-Jurisdiction Risks and Timing in the Provision of Capital Infrastructure, by Bargain Type

Types of Bargaining	Degree of Financial Risk to		Degree of Political Risk to		Point of Payment by		Aversion Index
	Developer	Jurisdiction	Developer	Jurisdiction	Developer	Jurisdiction	
Payments in lieu of taxes	+	0	0	0	0	—	1
Public improvements in the project area	+	+	+	+	+	—	5
Lump sum payment	+	+	+	+	+	—	5
Construction and long-term financing of a public improvement, with possible repayment	++	0	++	+	+	—	6
Public improvements outside project area	+	+	+	+	+/++	—	5.5
Construction of public improvements to gain points under a growth management plan	+	0	+	+	+/++	—	4.5
Joint public and private use of shared facilities	+	0	+	+	0	—	3

Developer provision of shared services, reducing both capital and operating budgets of jurisdiction	+	0	+	+	0	—	3
Developer maintenance and operation of public facilities or places	+	0	+	+	0	—	3
Conditions upon developer activities which facilitate accomplishment of public purposes	+	0	+	+	0	—	3
Modification of project to meet public policy purposes	++	+	++	++	0	—	7
Acquisition of real property by developer for jurisdiction's purposes	++	+	++	++	++/+	—	8.5
Profit sharing with the jurisdiction	+	0	+	+	0	—	3
Development of public property or resources to provide revenues to the jurisdiction	++	+	++	++	—	—	7

Key: For financial and political risk: high = ++
low = +
none = 0

For point of payment: pre-vesting = ++
pre-project completion = +
long-term = 0
not applicable = —

Aversion Index:
++ = 2
+ = 1
0,— = 0

costs as far as possible is that both anticipate revenues from a successfully completed project. These revenues can be used to offset, amortize, or otherwise cover capital costs more easily than is possible at the front end of a project when cash is typically in short supply.

Figure 7.2 also includes an "Aversion Index" constructed by weighting the items in the matrix equally. In reality, the items are likely to be weighted unequally. For example, political risk could be feared more than an early payment. To some extent, our expectations in this regard have influenced entries in the matrix. While undeniably an approximation, the calculation of the aversion index in this (and subsequent) matrices allows exploration of how alternative modes of providing capital infrastructure compare one to another. Types of bargains scoring higher on the index are likely to be avoided and resisted, thereby occurring less frequently, while those with lower scores on the index are more probable.

However, this calculation does not include the "non-bargained" instruments for provision of capital infrastructure, such as development fees and dedication requirements. An estimate of their attractiveness to developers and jurisdictions is offered in Figure 7.3.

Figure 7.4 compares aversion indexes of Figures 7.2 and 7.3, suggesting why jurisdictions and developers alike engage in bargaining as opposed to the traditional mechanisms of providing capital infrastructure. Several of the bargain types have lower aversion index ratings than do any of the traditional instruments except intergovernmental transfers, an option declining in frequency and over which local jurisdictions and developers have little control. Figure 7.4 also shows aversion indexes of jurisdictions and developers separately. This calculation shows that jurisdictions almost always reduce their aversion index by bargaining, with only dedication requirements occasionally surpassing those alternatives in attractiveness.

To conclude, this analysis of how jurisdictions approach bargaining argues that they place it in a context of available alternatives. While quantitative data is not available to analyze the pattern of bargains which occur, nor their extent, for that matter, our behavioral analysis suggests how developers and jurisdictions will evaluate bargaining. Both jurisdictions and developers were assumed to be risk averse and to prefer deferred costs. But the consequences of choice of instrument differ. Jurisdictions should prefer bargaining virtually always by this analysis, and developers prefer it on occasion. Of course, they have little choice, once they hold land in a jurisdiction.

Figure 7.3: Matrix of Developer-Jurisdiction Risks and Timing in the Provision of Capital Infrastructure, by Traditional, Non-Bargain, Instruments

	G.O. Bonds	Revenue Bonds	Tax Allocation Bonds	Capital Reserves	Inter-Governmental Transfers	Development Fees	Dedication Requirements
Degree of Financial Risk							
to developer	–	+	+	–	–	+	+
to jurisdiction	++	+	+	++	+	++	+
Degree of Political Risk							
to developer	–	+	+	–	–	0	+
to jurisdiction	++	++	++	++	+	+	+
Point of Payment							
by developer	–	0	0	–	–	++	+
by jurisdiction	0	–	–	++	–	–	–
Aversion Index	4	5	5	6	2	6	5

Figure 7.4: Aversion Indexes of Jurisdictions and Developers, by Method of Providing Capital Infrastructure

Instrument	Aversion Indexes		
	Jurisdiction	Developer	Total
Traditional:			
G.O. Bonds	4	0	4
Revenue Bonds	3	2	5
Tax Allocation Bonds	3	2	5
Capital Reserves	6	0	6
Intergovernmental Transfers	2	0	2
Development Fees	3	3	6
Dedication Requirements	2	3	5
Mean Aversion Indexes	**3.28**	**1.43**	**4.43**
Bargaining:			
Payments in lieu of taxes	0	1	1
Public improvements in the project area	2	3	5
Lump sum payment	2	3	5

Construction and long-term financing of a public improvement, with possible repayment	1	5	6
Public improvements outside project area	2	3.5	5.5
Construction of public improvements to gain points under a growth management plan	1	3.5	4.5
Joint public and private use of shared facilities	1	2	3
Developer provision of shared services, reducing both capital and operating budgets of jurisdiction	1	2	3
Developer maintenance and operation of public facilities or places	1	2	3
Conditions upon developer activities which facilitate accomplishment of public purposes	1	2	3
Modification of project to meet public policy purposes	3	4	7
Acquisition of real property by developer for jurisdiction's purpose	3	5.5	8.5
Profit sharing with the jurisdiction	1	2	3
Development of public property or resources to provide revenues to the jurisdiction	3	4	7
Mean Aversion Indexes	**1.57**	**3.00**	**4.61**

8

Anticipating the Consequences of Increased Bargaining

Previous chapters have described the variety and range of bargaining already occurring and have analyzed the changing context in which capital infrastructure is being provided. Those analyses lead to the prognosis that bargaining between developers and jurisdictions will increase over the foreseeable future. Jurisdictions have strong incentives to shift the cost of capital infrastructure toward developers who have little ability to resist this trend. They prefer bargaining to not being able to develop at all, and, in some cases at least, the bargaining results in preferrable outcomes to them than would an alternative such as dramatically increased development fees.

This chapter seeks to anticipate the consequences of increased bargaining. Four areas of possible impacts will be analyzed:

- possible distributional impacts upon citizens, shifting the incidence of financing capital infrastructure or the benefits received from development among categories of citizens;
- possible impacts upon the type of development which occurs (e.g., commercial vs. residential);
- possible impacts upon types of jurisdictions, shifting relative development rates or mixes of development within localities; and
- possible impacts upon developers, advantaging some and disadvantaging others.

By and large, these questions are related to what economists call "incidence" effects. For example, Break (1974:23) approvingly adopts Musgrave's concept of incidence as any change in the distribution of real income available for use by individuals brought about by a given public finance instrument. This analysis begins with the question of incidence, but is ultimately extended to the impacts of bargaining upon jurisdictions, types of development, and developers. These are "intermediate" issues somewhat distinct from the classical concerns of analyists of incidence, but also critical to policy makers.

An Introduction to the Analysis of Incidence

The most fundamental point about the incidence of taxes is that their ultimate impacts are not always on those upon whom the tax is levied. For example, a property tax levied upon the owner of a shopping center could ultimately be a burden upon that owner, the firms leasing space in the shopping center, residents of the jurisdiction who use the center, residents of other jurisdictions who use the center, owners of the land before it became a shopping center, or nearby residents who do not use the center. The payer of the tax according to statute may not bear the economic burden of the tax. As will become evident shortly determining who ultimately bears the economic burdens of the public-private bargains analyzed here is particularly difficult. But answering this question is important. In the absence of knowing who bears the burden of taxation, no discussion of equity issues is possible. Nor is it possible for policy makers ignorant of the incidence of taxes to accurately judge the impact of alternative public fiscal instruments upon the efficiency with which society's resources are used.

To sort out these complex issues, it is important to start with a recognition that all taxes are ultimately borne by individuals, either as owners of a factor of production, as laborers, or as consumers. A tax imposed upon a corporation, land, or a transaction is ultimately borne by specific individuals. Of particular importance to economists, policy-makers, and citizens in this nation has been incidence upon individuals of different incomes. Commonly analyzed as incidence upon households of various income classifications, a tax is said to be progressive if it is borne disproportionately (in taxes paid relative to income) by those of higher income, regressive if the opposite is true, and proportional if of the same proportion regardless of income.

Economists distinguish between incidence effects upon the *sources of income* of individuals and upon their *uses of income.* Sometimes a tax is levied on one side or the other of an individual's economic activities. A personal income, capital gains, or payroll tax is levied upon the sources of income. A sales or consumption tax is levied upon the uses of income. All individuals both receive and use income, so the ultimate objective of the incidence analysis is still to determine burden upon individuals. The sources of income for individuals differ, as do patterns of use. Taxes of equal yield, providing the same revenue to the public sector, have very different incidence effects depending upon what types of incomes or uses are taxed.

For example, income from dividends on publicly traded corporate stock goes overwhelmingly to households in the very highest income categories, while wages and salary income is received predominantly by those whose total household income is at the median level or above, and most income from pensions and annuities is received by households whose total income lies below the median (Break, 1974:120). Taxes bearing on these different income streams would have different incidence effects even when yielding identical revenues. Similarly, households spend their income in ways that reflect income categories, with those of lower income using proportionately more on food and housing and on consumption in general (as opposed to sav-

ings). For this reason, any tax burden falling on general consumption is believed to be regressive.

Public sector revenues are, of course, used for purposes that yield benefit to individuals. Sometimes benefits are quite directly and easily attributable to an individual, such as the individual whose property increases in value because a nearby public works investment or the recipient of an income transfer. Sometimes the benefit approximates a "public good" in which all individuals in a jurisdiction benefit. National defense is one example of this sort. Most frequently, the benefits of any public activity are received partly by easily identifiable individuals and partly by a less easily identifiable, but still real, category of individuals. This is true of the income transfer and public works examples given above. Other members of society may benefit from the income transfer through achievement of a social equity goal which they value. And many public works investments provide benefits beyond identifiable nearby properties, as would be received, for example, by those traveling or shipping goods on a highway.

Thus, complete analysis of incidence effects must be based upon determination of the incidence of *net burdens,* of taxes borne less benefits received. This is particularly important in analysis of the incidence effects of the types of bargains of concern here. A moment's reflection upon the examples presented in previous chapters reveals that each yields benefits to various categories of individuals. In each case, the developer received benefits from ability to complete the project as did the users of the development that occurred, be they residents of dwelling units, commercial or industrial firms located in the development, or shoppers and employees. In other cases, the general population of the jurisdiction received benefits, as happens when it receives augmented services as a result of the bargain struck as a condition of new development.

Determining who benefits, and to what extent, from the sort of activities being analyzed here is often as problematic as is determining the burden of costs. But the concept of incidence should be clear: it is the net burden of economic impacts upon individuals resulting from public finance decisions.

Importantly, patterns of incidence from the same public finance instrument may shift over time. This occurs as individuals adjust behaviors to their net burden of incidence. If these adjustments could be instantaneous and all individuals held immediate and full knowledge of the impacts of a new fiscal instrument, no differences in short-term and long-term incidence effects should occur. But those conditions are not often met in the dynamic context of financing capital infrastructure of concern here. As a consequence, short and long term incidence effects may be expected to differ as information is acquired and behaviors modified.

A simple example of how such a shift could occur is found in the likely shift, over time, in the incidence of increased development fees toward landowners. When first imposed, they may be borne by the developer holding land or with a project in progress, or shifted forward, if possible, to those who purchase or otherwise use the development. Over time, however, the incidence may be expected to shift to the owners of yet to be developed land.

This will occur because developers will calculate the increased development fees in their cost basis as they decide what price to offer for a potentially developable parcel. If a competitive market exists among developments in several jurisdictions, the prices for similar developments must be a least roughly equivalent. If the developer cannot find a land owner in a high fee jurisdiction willing to lower price to offset this cost differential, the developer will rationally choose to develop elsewhere. Until the landowner adjusts parcel price to account for the cost difference, the parcel should not sell. If there is a shortage of developable land, this effect may be delayed, or the incidence shifted elsewhere. If the developer is also the landowner, then he or she must bear the increased costs or seek to shift them forward to users of the project.

The attentive reader will note that this particular shift in incidence occurs only because there is a difference in fees among jurisdictions. If all jurisdictions charged identical development fees, the factor of development fees should not cause any difference in land prices. In a case where all jurisdictions raised development fees equally, the burden could still be shifted to landowners if developers and consumers signalled their refusal to bear the burden by ceasing to develop or purchase until land prices were reduced to offset the fee increase. Economists call this process of adjusting the price of an asset (such as land) to a change in its use value "capitalization."

A final point concerning the analysis of incidence effects is to note that what is usually of concern is *differential* incidence. A proposed fiscal intrument is not often evaluated solely on its own attributes, but in comparison with an existing or alternative system. Adopting this comparative approach lessens some methodological problems with alternative strategies of analysis (see Break, 1974:129) and is also reflective of how choices among alternative policies are made. The behavioral model developed in Chapter 7 of this study argues that choices among methods of providing capital infrastructure for new growth are explicitly tradeoffs among alternatives, for example.

Before beginning the analysis of the incidence effects of bargaining concerning provision of capital infrastructure, an examination of the relevant features of that process is warranted. In addition to the obvious ordinary difficulties in actually determining the incidence effects of a fiscal instrument suggested by the preceding discussion, the bargains of concern here pose additional obstacles.

A first obstacle is that there is very little existing literature on the incidence of fees and charges, let alone of the complex bargains analyzed here. There are virtually no empirical analyses in this area and only a smattering of conceptual analyses (see, for example: Hagman and Misczynski, 1978). There are no well-marked paths by which to pursue this task. Existing analyses of the property tax and of excise taxes are of some assistance, however. Previous studies of the incidence of the property tax are particularly useful on such critical points as the dynamics involved in shifting incidence over time, an issue already raised.

A second obstacle to successful study of the incidence of the bargains analyzed here is that they are not uniform. We are not dealing with a "common" tax, such as the property tax, the secondary features of which may

vary (such as assessment practices) but which remains everywhere a tax on property. The only unifying definition of the bargains considered here is that they arose out of project-specific negotiation between a developer and a local jurisdiction.

Third, while most empirical studies of incidence ignore the issue of the benefits derived from public expenditure and instead focus upon the taxes imposed, this bias appears unsatisfactory in this case. Capital projects are ordinarily characterized by a number of specifically benefited individuals. In some cases a broader, and perhaps even "public," benefit accrues. To limit the effort required in this area, we adopt the strategy of comparing differential impacts. Instead of asking, "what are the incidence effects of bargained capital investments?," the question becomes, "is there any reason to believe those patterns will differ from the incidence pattern of alternatives?"

Finally, both public and private policymakers, and the citizens of California, will be appropriately interested in the impacts upon jurisdictions and developers of an increased shift of the capital costs associated with new development to the private sector through project by project negotiation. While classical incidence analysis seeks understanding of impacts upon individuals, in confronting choice, the impacts upon societal institutions of collective action is also critical. We might, for example, not desire to choose an alternative for financing new development that had the consequence of dramatically skewing the ability of jurisdictions to grow if they desire.

While this concern can be restated in terms of individual values (for some equity among jurisdictions' long-term capacity for growth) to do so misses an important point. Economic or political theories which construct their processes of logic upon the satisfaction of individual preferences encourage the undervaluing of institutions of social choice and action. Many individual objectives can only be achieved in the first instance through social institutions (such as the provision of a public good). More importantly, change occurs; new preferences emerge over time. Economics has a well-developed theory as to how competition among firms accommodates such change, but largely ignores the issue of how governments should be structured for the same purpose.

With a very different logic, some political theories similarly encourage ignoring sustained capacity of the political system as a needed societal construction for choice and action into the future. Included in this category are those political theories and ideologies which focus upon achievement of particular end-states for society or individuals. Marxian communism, for example, encourages pursuit of a particular ultimate manner of organizing society, after which no further change is expected. In an example closer to our recent experience, it was common for policy makers in the 1960s and 1970s to place the achievement of a particular "national" policy objective above the functioning, or even existence, of local political jurisdictions. Society may be more perfect if every individual has equal opportunity, the environment is fully protected, or a particular favored method of organizing public employment is followed nationwide. But achievement of our next series of policy objectives will require political capacity, a need easily ignored from the perspective of those pursuing a particular policy objective (Kirlin, 1982).

To accommodate these concerns with institutions, we will go beyond traditional analyses of economic incidence. However, the incidence analysis provides a basis for the extension to institutional issues, so it must be completed first. Attention now turns to that task, beginning with an exploration of the issue of who *might* bear the incidence.

Who Might Bear the Incidence?

A first step in analyzing the potential incidence of the sort of bargains described in Chapters 3 through 5 is to identify those who could conceivably be impacted. Some of those potentially impacted have already been mentioned. Nevertheless, they are again included here so that all may be discussed equally. In each case, those individuals potentially impacted are identified and a brief explanation of how they could benefit or lose is presented.

- *Taxpayers of the jurisdiction.* Existing taxpayers of a jurisdiction in which new development occurs can receive benefit or costs, and are likely to receive some mixture of both. Benefits received could include improved services or reduced taxes and fees. Costs borne could include exactly the opposite: reduced services and increased taxes or fees.
- *Developers.* Developers typically benefit (or at least plan to) from project completion, receiving some form of income for their role. They can also bear costs, most obviously in the case of actual losses on a project, but equally importantly to them in lower profits than their investment and efforts would have earned in alternative uses.
- *Landowners of developable parcels.* As suggested above, the values of yet undeveloped land may shift to capitalize changes in potential income streams. In the example presented earlier, parcel value declined, but it could equally well increase, as would happen if only a few jurisdictions were willing to allow growth financed through bargaining, increasing the returns to development within their borders.
- *Residents and landowners of other jurisdictions.* When one jurisdiction allows development in general, or changes the historic pattern of apportioning costs and benefits associated with new development between the public and private sectors, impacts also occur in other jurisdictions. These effects occur because mobile factors, such as investment capital, labor, and residents, will seek jurisdictions maximizing their net benefits, suggesting any jurisdiction with obvious fiscal burdens will lose those factors to jurisdictions considered more attractive.
- *Labor.* If labor is not as mobile as business investment, workers in a jurisdiction with a high fiscal burden may find their earnings depressed as businesses seek to achieve yields on investment comparable to other jurisdictions. Where barriers to wage adjustments exist, such as a large percentage of the labor force having wages set in national collective bargaining, business investment should decline in high tax jurisdictions, causing disinvestment which reduces employment opportunities.

- *Users of the development.* Much as immobility allows the shift of net fiscal burden to landowners or, in some cases, to labor, users of development in a high tax jurisdiction may find their private economic well-being reduced as the incidence of increased fiscal burden is shifted to them.

What May Occur

As should by now be apparent, anticipating the incidence effects of increased bargains of the sort being analyzed in this volume is both difficult and risky. So too, however, should be the importance of at least trying to anticipate those effects. What follows is such an attempt. It must be recognized as tentative, as offering prognoses that should be evaluated and adjusted as experience accumulates.

One preliminary issue which must be considered is the possibility that shifting more of the burden of financing capital infrastructure for new development to the private sector will affect the production efficiency with which that infrastructure is provided. This issue is important, as it affects the balance between costs and benefits of the investment. If the private sector provides equivalent capital infrastructure at a cost less than does the public sector, less net burden would result as a consequence of shifting provision to the private sector. If the public sector is more efficient, a greater net burden would result.

Available evidence suggests that the private sector is often more efficient in the provision of at least some "public works" services and maintenance operations, such as street repair, street sweeping, and refuse collection (Savas, 1977; Roy Jorgeson Associates, Inc., 1981). But the borrowing costs of governments are likely to be lower than those of developers. On the balance there is little reason to expect substantial differences in the costs of identical capital construction projects provided by the public sector versus those provided by developers. Both follow similar bid procedures to select construction firms and any possible differences in other features of their procedures, such as time delays between bid submission and project initiation or bonding requirements, should not be substantial enough to yield marked cost differences. This analysis precedes on the assumption that there are no net efficiency effects of sufficient importance involved to warrant inclusion.

As has already been discussed, a sensible way to approach the analysis of incidence effects is to seek to determine the differential impacts of the fiscal instruments of interest in comparison with alternative instruments. For this analysis, two alternatives are considered. The first is the historical pattern that existed prior to passage of Proposition 13. That pattern consisted of substantial direct public provision of capital infrastructure. Much of this was financed by general obligation debt. Developers paid fixed development fees, met prescribed dedication requirements, thus also bore a substantial portion of the capital infrastructure cost.

Identifying a second alternative is difficult, as it should be an alternative

to the bargaining under analysis here, yet it must be a departure from past practice. The alternative chosen is what may be termed as "worst-case scenario," in which no new tax sources are provided to cities and counties, their abilities to impose development fees are narrowly limited to uses of immediate benefit to the project, and the sort of flexible bargaining described in Chapters 3 through 5 of this volume is stopped, either as a result of court decision or state policy.

While draconian, this scenario is not implausible. Existing case law on exactions, including development fees, legitimizes their use only where there is a reasonable relationships between fee and demand of the project for new public services. Policies which seek to expand this limit are subject to legal challenge, and the standard could be further tightened. Political issues raised by bargaining have been discussed in Chapter 6; the legal issues involved are discussed in the next chapter. In both cases it is conceivable, although we believe undesirable, that significant constraints upon bargaining between developers and jurisdictions could arise. While new tax revenues could be raised through several alternatives, such as a sales tax increase or a split-roll property assessment procedure, cuts in state tax revenues are also possible (for example, if the initiative to permanently and fully index the personal income tax). Additional tax cuts would very probably cause the state to terminate the general purpose fiscal assistance to cities and counties initiated after passage of the Jarvis-Gann Initiative.

Specific discussion of the incidence of bargains between developers and jurisdictions can begin by considering how each of those identified earlier as potentially impacted might fare under bargaining and the two alternatives just discussed. An estimation of such impacts is shown in Table 8.1. The estimates make one heroic assumption that must be obvious to the reader. "Bargains" are treated as a single category of public fiscal instruments. But Chapter 3 showed how bargaining occurred in many legal contexts, Chapter 4 delineated among more than a dozen different types of bargains, and the cases presented in Chapter 5 illustrated that more than one type of bargain, and often more than one legal arena, may be evident in a single case. But treating all bargains as equivalent facilitates analysis, which would otherwise be very cumbersome. It also is appropriate given the present lack of precise understanding of the impacts of specific bargains; being more abstract introduces a needed tentativeness to the enterprise.

Table 8.1 seeks to anticipate how each category of individual will be impacted by the three alternatives. Taxpayers are generally advantaged by bargaining, which ordinarily shifts the costs of financing capital infrastructure away from them, particularly in comparison with the old, pre-Proposition 13 system. If the worst case scenario severely retards growth, as seems likely, taxpayers would also be impacted negatively as the economy of the jurisdiction gradually declines.

Developers usually did well under the old system, can do well under bargaining, and if relocation is feasible, may even not be dramatically damaged by the worst-case scenario. To some extent, this conclusion follows from the expectation that developers are, ultimately, mobile to some degree. If they cannot receive returns they believe adequate in one location, they may

Table 8.1: Estimating the Differential Incidence Effects of Bargaining and Two Alternatives Upon Categories of Those Potentially Impacted

	Bargaining	Old System	Worst Cast
Taxpayers	+	—	—
Developers	+	+	0/—
Landowners	—/0	+	—
Residents and Taxpayers of other jurisdictions	0	—	+
Labor	+	+	—
Users	—	+	?

Key: "+" helped by the incidence
"—" hurt by the incidence
"0" no effect

attempt to shift jurisdictions or even diversify into other activities than development.

Landowners benefited from the old system which provided opportunities for windfalls arising from broadly-financed public improvements. After a transition period, the costs nominally imposed on developers are likely to be shifted to landowners, as already discussed. However, bargaining does allow more development to occur than would the worst-case scenario. Thus, while a shift in the costs of providing capital infrastructure for new development from the public to the private sector is likely to be capitalized as lower parcel values for landowners, severely constrained development prospects would also be capitalized, as even deeper reductions in possible sales prices. In the long run, if rezoning increases or decreases the number of available parcels in a jurisdiction, these effects could be confounded. For example, if a landowner whose parcel decreases in value because of the capitalization of the costs imposed by bargaining succeeds in seeking a rezoning to a higher use, full capitalization might not occur.

Impacts upon other jurisdictions are hard to evaluate, both because of uncertainty concerning the extent and variety of bargaining that will occur and the inherent difficulties in sorting out possible incidence effects. The estimates provided in Table 8.1 define "other jurisdictions" as other states. If bargaining becomes widespread in California over the next decade, differential incidence effects within the state may be modest. To the extent, however, that California is unable to provide sufficient capital stock for growth (a possible consequence of the worst-case scenario), other states are likely to benefit from the transfer of mobile factors of production, capital, and labor, out of the state in search of higher returns. This is, of course,

already happening as a result of differentials in housing costs between California and other parts of the nation (Kimbell and Schulman, 1981).

Within the state, jurisdictions that turn to bargaining relatively quickly and fully, and are willing to accept job and population growth, should achieve the overall pattern of incidence effects shown in Table 8.1 under the "bargaining" column. Jurisdictions choosing not to grow, or not aggressively bargaining with developers for the provision of capital infrastructure, should end up with a pattern of incidence resembling the worst-case scenario. In other word, the horizontal entries for "residents and taxpayers of other jurisdictions" compares California with other states. Jurisdictions within California may be compared vertically according to how their policies match the three alternative scenarios.

Labor is expected to be beneficially impacted by both the old system and bargaining, as both allow for growth in employment opportunities. In contrast, the worst-case scenario depresses job creation, reducing opportunities for employment.

Users of development projects, the residents of residential projects, or commercial and industrial firms which own or operate in non-residential projects, probably received windfall benefits from development under the old system, in which substantial capital costs were typically spread over the whole tax base of the jurisdiction. Under bargaining, they are less likely to do so, resulting in a prediction of negative effects. If the worst-case scenario constrains growth, users can be affected in a variety of conflicting ways. Owners of desirable properties may find their values increased, a pattern already occurring in California as a result of restrictions upon growth. Those who rent or lease property may find themselves impacted negatively by increased rental costs, costs which they must bear if they are unable to pass them to some other category of individuals. *Potential* users, those who desire to purchase or lease residential or non-residential property, bear a negative burden of either using a higher proportion of their assets and income for land and structures or of being displaced to another jurisdiction where those costs can be accommodated by their budgets.

In summary, only a qualitative analysis of the incidence effects of bargaining is possible. Moreover, only a differential analysis is possible, comparing the incidence effects of the bargaining family of policy strategies to two alternatives. Nevertheless, some important conclusions may be drawn from this analysis.

Most importantly, the incidence effects of the sort of bargaining that is now going on between developers and jurisdictions may be tolerable. In time, if this analysis is correct, owners of potentially developable land will bear most of the burden in the form of lower prices for their land as they are forced to capitalize costs nominally imposed upon developers. Landowners and users are the only two categories of individuals who fare worse under well-established bargaining than they did under the old, pre-Proposition 13 system of financing capital improvements. They do so because they lose opportunity for windfall increases in property values arising from public investment. Many policy makers and citizens would probably believe removal of this

potential for windfalls to be just and equitable. Reducing potential profits is likely also, however, to reduce incentives for risk-taking, thereby depressing development activities.

Nearly as importantly, the incidence effects of bargaining are strongly preferrable to those of the worst-case scenario. Only jurisdictions outside of California and some users should prefer the incidence effects of the growth constraints caused by the worst-case scenario.

Given these anticipated incidence effects, bargaining appears acceptable. The world of development finance that existed prior to 1978 is unlikely to be recreated. And the worst-case scenario is, by this analysis, decidedly inferior in incidence effects to bargaining. Its corollary effect of growth control will, however, ensure that the worst-case scenario has many advocates. So too will the effect of enriching some present property owners make the worst-case scenario an attractive option.

No analysis can resolve the conflicts involved in these choices, but it can illuminate the tradeoffs embedded in the alternatives. As stated early in this chapter, policy makers and citizens of California should also consider impacts beyond the incidence effects commonly discussed by economists and just explored here. Attention now turns to this issue.

Additional Impacts

Five potential impacts of bargaining beyond the incidence effects just analyzed are explored in this section. Included are potential impacts of bargaining upon: (1) the development industry, (2) the types of development favored, (3) the efficiency with which capital infrastructure is provided, (4) jurisdictions, and (5) the political system of the state.

Historically, the *development industry* has been characterized by its openness, competitiveness, and entrepreneurial character. Large development firms have been rare, as have been old firms. Most development is the product of organizations (often small) still actively dominated by their founder.

One likely consequence of increased bargaining between developers and jurisdictions and a shift of capital costs to the developer is a change in the historical structure of the development industry. In response to the demands for more front-end capital (to cover costs previously borne by the public sector) successful developers will need larger capital reserves. This may occur even if, as was just argued, the eventual, ultimate incidence of a shift of cost to the private sector is more likely to fall on landowners than on developers.

As a first explanation of how this could occur, it should be remembered that the shift of incidence from developer to landowner is not instantaneous. It occurs only as developers exhaust their current land holdings and acquire land for future development at a price that capitalizes their increased costs. This process could occur quickly in areas where only a few developers have banked land and substantial amounts of developable land (relative to demand) are held by many owners. In such a situation, competition among landowners should speed the capitalization process. But not all situations

will have these attributes. Some developers already hold substantial land for future development. In some localities, developable land is scarce, or held by a limited number of owners who may resist price reductions. While the ultimate capitalization process is working itself out, perhaps over several years, developers will bear more of the burden of the cost shift, increasing their need for capital.

Even after the shift in incidence, developers may need more capital than under the old system. This could occur if they acquire land on credit terms more favorable than they obtain working capital. Consider the hypothetical case of a developer who typically acquires land with partial down payments, paying interest on the balance to the seller until project completion, at which point the balance of the purchase price is paid off. If that developer must fully pay for bargained public improvements at the front end of a project, his capital reserves must be reduced or the needed money borrowed, commonly at interest rates higher than those charged by sellers of land. Even if the purchase price of the land was reduced to capitalize the added costs of the additional public improvements required as a result of bargaining between developer and jurisdiction, the developer needs a larger personal capital reserve or access to a larger line of credit.

Yet a third explanation is available for why developers may need more capital: uncertainty. Whereas the cost apportionment between public and private sectors occurred according to fixed and relatively stable rules in the old system, that is no longer so. In a world where costs are apportioned on a project by project basis, greater reserves are likely to be required for long-term survival of developers. This will occur because the outcome of bargaining of this sort is not fully predictable and is very frequently not known when the developer commits to a project. It is reported, for example, that many proposed developments in Los Angeles County receive tentative parcel maps (at substantial effort and cost to the developer), but are never completed, partially, it is believed, because the conditions imposed at that time by the county for approval of the final map are surprisingly onerous to the developer. This suggests that effective bargaining is not occurring; instead such a process should be considered one of unilateral exaction. In an effort to reduce this problem of ignorance and uncertainty, Los Angeles County has established a one-stop procedure where potential developers may dicuss the likely decisions of the County before they even purchase the parcel involved.

Astute developers will seek to mitigate such risk (for example, by making the purchase price of land contingent upon the outcome, effectively shifting incidence to the landowner), but they will not always succeed in doing so and will sometimes underestimate the costs of the bargains ultimately struck. If short of capital reserve, they may lack the staying power to survive these miscalculations.

Beyond capitalization, developers will need access to increased professional skills to negotiate effectively with the jurisdictions and to implement the bargains that result. In some cases, developers are also finding that they must provide the professional services needed by the city or county with which they are bargaining. For example, the developer's attorneys often draft legal documents needed by local governments and his engineers may design

public works projects or do the calculations necessary to establish assessment districts.

Both the requirement for larger capital reserves and access to greater credit, and the need for increased professional competencies, should work to advantage larger developers. But this outcome is not automatic. Development occurs in a complex environment where access to credit is (at least in normal times) available even to smaller developers if the project is attractive. And professional expertise need not be provided by one's own employees but is available for purchase. Still, the shift to bargaining is likely to result in a context favoring larger developers.

Public policies can affect this trend, either accelerating the movement to large development firms or providing space for the continued existence of a mix of larger and smaller firms. If public jurisdictions emphasize large projects or push increased costs onto developers as front-end lump payments rather than structuring them in ways that spread over the project life, they will encourage large development firms. An example of such an approach was seen in the proposed California Communities Act (AB 893, Roos), passed by the Legislature but vetoed by Governor Brown in 1981. That bill would have created five large mixed-use new communities, with the developer providing all capital infrastructure either directly or with financing by a tax-increment financed developement district. Proponents of the bill argued that one of its advantages was that only the largest developers could participate, which they believed would result in "quality" projects.

Probable impacts upon *types of development* are of two kinds: mix and scale. The most reasonable expectation is that projects with commercial uses will be favored over those involving industrial and residential uses. Commercial projects continue to offer their historical attraction of sales tax revenues. In addition, commercial projects more easily lend themselves to profit or equity participation by jurisdictions, a rare result of bargains now but a feature jurisdictions are likely to pursue more aggressively in the future. The cases discussed in this volume generally bear out this expectation, with the majority being either solely commercial projects or ones mixing commercial with industrial and residential uses. Whether these cases are an accurate sample of all that is occurring is not evident. A bias toward commercial projects should not be surprising, however, as it existed even in the pre-Jarvis-Gann system of development. An ultimate constraint upon this pursuit of revenues may be found in the Gann Initiative (Proposition 4, adopted in November 1979).

The issue of the size of development encouraged by bargaining has already been raised. Larger projects tend to be easier targets for bargaining. Their scale usually requires substantial investment in infrastructure, and the shift of the costs for these needed improvements can be quite easily made a condition of project approval. Larger projects are also proposed by developers with greater access to capital and technical expertise, factors which facilitate bargaining. Thus, bargaining may be expected to encourage bigger developments.

More important than these expectations concerning the impacts of in-

creased bargaining upon the size and types of developments is recognition that the state and local governments of California need not accept these trends passively. Through their policy making, they can, if they so desire, modify these trends. How they may do so is taken up in the last chapter of this volume.

Somewhat related to the prior issue is the possibility that bargaining may impact upon the efficiency of the provision of capital infrastructure. The concern here is not with the possibility of differences in "production" efficiency between the public and private sectors which was discussed earlier in this chapter, but with what economists would call "social" efficiency. Choices are efficient in this sense if they make fullest use of society's resources. Technically, choices concerning resource use are said to be efficient when there is no possibility to make a change which helps some individuals in society without hurting others (the concept of Pareto optimality).

If the opportunity to bargaining encourages jurisdictions to negotiate for "excess" public works, this would be inefficient because the resources consumed for this excess could be diverted to another purpose (maintenance of a deteriorating public facility or private consumption, for example) that would provide benefit to some individuals while harming none. Alternatively, underinvestment in capital infrastructure could occur if the jurisdiction is unable to produce (directly, or through such devices as dedication requirements or bargaining) capital infrastructure at the level preferred by individuals in the society. One way that this can happen is as a result of "free-rider" dynamics. As many capital infrastructure projects are social goods the benefits from which it is undesirable or infeasible to exclude individuals, each has an incentive to not contribute resources to the project, instead waiting until others provide them and then enjoying the benefits. An example of this could occur where several parcels of land will become developable upon construction of a storm drain system. Individual parcel owners may seek to avoid contributing to the construction of the drainage system in hopes of being free-riders. Among the policy instruments developed to overcome this problem are assessment districts and taxation.

Bargaining has no predictable effects upon efficiency. Scenarios in which both over- and under-provision of capital infrastructure are provided are plausible. Some jurisdictions with strong leverage over some developers will exact "bargains" which entail the provision of public works projects in excess of need. In other instances, the barriers to successful bargaining or free-rider dynamics will prevent capital infrastructure being constructed which would increase the efficiency of resource use.

As in many of the judgments concerning the desirability of bargaining, comparison with available alternatives is the most reasonable test. In this regard, it may be said positively of bargaining that it is recognized to be a desirable strategy for resolving the free-rider problem, especially in cases where the number of parties involved is small (Musgrave and Musgrave, 1976:66-80).

Jurisdictions may also be impacted by the replacement of the old system of capital financing for growth with a system based on bargaining. Some

of these impacts were analyzed earlier in this chapter when it was argued that jurisdictions which more quickly and fully embraced bargaining would be advantaged, in terms of economic incidence effects, than those which lagged behind. Some jurisdictions may perceive themselves to be disadvantaged in the new system, arguing that they are built out "to capacity," or do not have large enough tracts of land to mount large scale developments which facilitate bargaining.

These fears should not be dismissed lightly; any system of public finance has biases. But virtually any jurisdiction in California which is willing to accept economic and population growth can use bargaining to provide the capital infrastructure needed to accommodate that growth. There is undeniably greater developer interest in northern San Diego County than Calexico, so this assertion must be tempered. Still, pressures for growth in California are strong. If the proposed growth in the economy of California could accommodate a population of more than 50 million by the turn of the century but housing prices will constrain growth to 30 million, substantial opportunities exist for jurisdictions to participate in that growth if they so desire.

Even jurisdictions with little undeveloped land could allow more growth through changes in land use and increased densities. Among the cases analyzed here, Santa Monica is a city which bargained to save a desired shopping center and uses its municipal powers aggressively to pursue desired objectives (but not dramatically higher densities), despite having little undeveloped land.

In short, the political choices of jurisdictions are likely to determine their use of bargaining more than their physical land use patterns. If they choose to grow they are likely to develop entrepreneurial attitudes, realizing that they can achieve their policy objectives and maintain a strong public policy presence in shaping the future of the jurisdiction through bargaining with developers to establish effective public-private sector partnerships. So too are they likely to develop the professional competence and political skills which allow them to bargain effectively.

Finally, bargaining can impact the *political system* itself. One risk is that citizens and (especially) state officials will come to fear and distrust this process, leading them to constrain its use. This action would have impacts upon the political system as well as upon the state's economy. Politically, it would probably result in the diminution of the powers of the public sector to shape the future of the state. A particular consequence could be the centralization of development decision-making at the state level, an action that would enfeeble local governments and exclude citizens from these decisions. The state presently has no technical, administrative, nor political competence to handle these issues, and a substantial risk is run that the resulting policy processes would not be effective. This prognoses is based on the tendency of larger units of government to fragment decision processes along functional lines (such as water, transportation, or air quality), a tendency which encourages paralysis in policy making and ordinarily results in limited capacity to make trade-offs among competing objectives and values. These tendencies are well-illustrated in the history of federal and state policies interven-

ing in land and resource use decisions (Kirlin, 1981).

More positively, successful and widespread use of bargaining could strengthen the political system in two ways. The first, and most obvious, is to accomplish transition to a new system of providing capital infrastructure; in short, to "solve" part of the fiscal crisis analyzed in Chapter 2. A second positive consequence would be the unleashing of public policy making from the shackles of suspicion and hostility between the public and private sectors. This issue is explored further in Chapter 10, but briefly stated, effective partnerships between the public and private sectors, of the sort that are possible to achieve through bargaining about development, can lead to a more powerful and vital political system.

9

Legal Issues Posed by Jurisdiction-Developer Bargaining

This chapter surveys key legal issues involved in jurisdiction-developer bargaining and identifies areas of legal uncertainty where state legislation or court decisions could facilitate, validate, or clarify bargaining limits. The first portion of this chapter identifies four basic legal structures or forms commonly assumed by jurisdiction-developer bargains.

The second and major portion of this chapter will focus on the legal constraints upon bargaining imposed by the longstanding rule that government cannot contract away the police power. The third portion of this chapter analyzes legal and policy implications of the transfer by jurisdictions to developers of "administrative" tasks and costs traditionally borne by the jurisdiction in public control of land development.

☐ Common Legal Forms Assumed by Jurisdiction-Developer Bargains

A survey of jurisdiction-developer bargaining suggests that it commonly takes one of the following forms:

A. Developer's "voluntary" modification of the project or incorporation of environmental mitigation measures after application filing but prior to final jurisdiction action on the project.

B. Developer's "voluntary" acceptance of conditions imposed upon project approval by the jurisdiction which exceed established constitutional or statutory limitations upon exactions.

C. Developer's recordation of covenants specially burdening or restricting land use.

D. Execution of a formal contract between the jurisdiction and the developer.

Each of these permits a more flexible approach to land use decision making than when the jurisdiction unilaterally reviews a project but is empowered

to impose only exactions reasonably related to public needs created by the proposed development. *Scrutton v. Sacramento County* 275 CA 2d 42, 49 CR 872 (1969).

The first form of bargaining identified — project modification and incorporation of environmental mitigation measures in the early stages of project review — was identified in the discussion of the Mitigated Negative Declaration in Chapter 3. As previously noted, this approach expedites project review but often effectively eliminates meaningful input into identification and acceptance of mitigation measures by citizens and even elected officials, an objective of environmental laws.

The prior discussion also noted that in some jurisdictions environmental mitigation measures either exacted from developers, or bargained for in some instances, often exceed the form of exactions authorized by the state Subdivision Map Act or skirt the rule that they must be reasonably related to public needs created by the development itself. In some instances, such mitigation measures or conditions of approval are extorted from the developer. He has no choice but to accept or risk project denial of costly delays. In other instances the developer's acceptance of the conditions is voluntary, reflecting a bargaining process in which his project constraints or objectives have been accommodated to some degree by the jurisdiction. This represents the second form of bargaining identified above.

A third common legal form utilized to effect a bargain is the developer's recordation of covenants restricting the use of his land. Such covenants are often used in a situation where the jurisdiction classifies property to a less restrictive zoning district but requires the developer to execute and record a document imposing use restrictions not required of other property in the same zone. An example would be a covenant to retain portions of the property in open space or to establish a large lot size, regardless of present or future zoning regulations to the contrary. Again, the scope of the covenant may either be confined to or exceed measures reasonably required to mitigate identifiable project impacts, depending on the willingness of the jurisdiction and developer to bargain creatively in order to maximize both public and private benefit from project approval.

Whether such covenants are obtained from developer applicants through bargaining or extortion, the relationship has been referred to variously as contract or conditional zoning. It has been criticized in legal literature and case law as illegal "spot zoning," and a violation of the principle of uniformity in the treatment of all properties within a zoning district. Some authorities also contend that it represents an illegal attempt to contract away the police power or to permit wealthy developers to "buy" zone changes. These issues are addressed at greater length below. For further discussion of the issues raised by contract or conditional rezoning, the reader may wish to refer to the following: Comment, "The Use and Abuse of Contract Zoning," 12 *UCLA L Rev* 897 (1965); Comment, "Contract and Conditionl Zoning, A Time for Zoning Flexibility," 23 *Hastings LJ* 8925 (1972); *California Zoning Practice* (1969 and supplements) §5.65-69, published by the California Continuing Education of the Bar; Longtin, *supra*, Section 2.150.

Care must also be taken in drafting the language of covenants and structuring the relationship of the parties to enable the jurisdiction to judicially enforce the covenants under property law principles which may require "privity" or the retention of some benefited property by the jurisdiction. Of course, the jurisdiction also retains a very direct and efficient means of enforcement in its ability to deny future building permit or development applications in conflict with the restrictive covenant.

The fourth general form which jurisdiction-developer bargaining may take is the contract relationship. On one hand, the contract relationship appears to offer the greatest degree of flexibility and freedom from traditional constraints on the bargaining relationship. On the other hand, it poses most sharply key legal issues which are common to all the bargaining relationships in varying degrees. These issues are discussed below. Then again, contracts make available traditional contract remedies to enforce the bargain in the event of breach or default. The contract relationship also more nearly equalizes the parties' relationship, thereby stimulating creativity and a spirit of partnership and maximizing the potential for mutual gain.

Legal Constraints on Bargaining

The principal legal issue presented by jurisdiction-developer contracts is whether they:

A. improperly "contract away" the police power and are thus invalid and unenforceable, *Avco Community Developers, Inc., v. South Coast Regional Commission* 17 Cal.3d 785, 553, P.2d 546, 132 CR 386 (1976); or

B. are valid contracts, enforceable and subject to the constitutional protection of the contracts clause prohibiting governmental action impairing the obligation of contracts (U.S. Constitution, Article I, Section 10, Chapter 1).

The response to this question is critical. If the contract is determined to be illegal it is void. Moreover, if there was no authority to contract, a court may find that there is no authority to adopt or ratify the agreement and that a contract in fact cannot be implied. A court may even refuse to apply estoppel or to grant quasi-contractual relief to a developer who has fully performed, because such relief would effectively enable the jurisdiction to do indirectly what it cannot do directly. See generally, McQuillan Mun. Corp. (3rd Ed.) Vol. 10, Sections 29.91-115; McCarthy, Jr., D.J. *Local Govt. Law,* pp. 168-178.

The following review of judicial decisions focuses first on the police power rule and then upon the limitations on that power implied in judicial interpretation of the contracts clause. Case law on these subjects does not provide a clear, satisfactory answer concerning the impact of these two countervailing rules upon the probable validity of jurisdiction-developer bargains. It follows that neither can this analysis provide a definitive answer on the validity of these bargains. The analysis can only highlight some of the key issues, opposing arguments, and legal principles involved.

In reviewing legal constraints upon bargaining — particularly through the vehicle of contracts — we are indebted to the authors of the following analyses of the legal issues posed by California's Development Agreements law (California Government Code Section 66864, et. seq.):

> Hagman, D.G. "Development Agreements," *Zoning & Planning Law Report,* Vol. 3, Nos. 9 and 10 (October, November, 1980); and Holliman, W.G. "Development Agreements and Vested Rights," *The Urban Lawyer,* Vol. 13, No. 1 pp. 44-64 (Winter 1981); and the *Development Agreements Manual* issued by the League of California Cities in 1981.

1. The Police Power.

Support for the validity of jurisdiction-developer contracts lies principally in several cases upholding the enforceability of annexation agreements between developers and the annexing jurisdiction. Such agreements have called, for example, for the developer to install certain improvements and pay certain fees in exchange for the jurisdiction's agreement to prezone, annex, provide sewage capacity, and install various public improvements. When the jurisdiction defaulted, the court enforced the contract in the face of the city's contention that the police power had been illegally contracted away. *Morrison Homes Corp. v. City of Pleasanton,* 58 CA.3d 855 (1965); *Wright Dev. v. City of Mountain View,* 53 CA.3d 274, 125 CR 721 (1975); *M.J. Brock & Sons, Inc. v. City of Davis,* 401 F.Supp. 354 (N.D. Cal. 1975, (dictum).

In *Morrison,* the court of appeal stated that the rule against contracting away the police power applies to and voids only a contract which amounts to a jurisdiction's "surrender" or "abnegation" of its police powers.

The court found that the annexation agreements at issue were "just, reasonable, fair, and equitable" for both parties at the time of their execution and that, therefore, they were neither void nor voidable "because some of their executionary features might have extended beyond the terms of office of any of the current City Council members." 58 CA.3d 724, 734. Further authority for this position may be found in *Denio v. City of Huntington Beach,* 22 Cal.2d 580, 140 P.2d 392 (1943).

2. The Contracts Clause.

A second line of support for the enforceability of jurisdiction-developer contracts and bargains is based upon the contracts clause of the U.S. Constitution. In *United States Trust Company of New York v. New Jersey,* 431 U.S.1 (1977), the U.S. Supreme Court, while not ruling directly on the issues presented in this study, strongly supported protection of public contracts against impairment by a subsequent exercise of the police power, unless reasonable and necessary for an important public purpose. In so doing, the court acknowledged that the police power is not absolute. The contracts clause, if it is to have any meaning, must provide some limitation on the exercise of the police power. See, also, *Sonoma County Organization of Public*

Employees v. County of Sonoma, 23 Cal.3d 296, 305, 152 CR 903 (1979). In *Sonoma*, the California Supreme Court upheld local government employee contracts in the face of subsequently enacted conflicting state legislation.

Read together, the annexation agreement cases and recent judicial pronouncements regarding the impairment of contract build a solid foundation for validating and enforcing jurisdiction-developer bargains. What is needed is a definitive case in the area of land use regulation to resolve the relationships between the free exercise of the police power, the contract clause, and the issues raised in cases on contract or conditional zoning. Moreover, it is worthwhile to examine closely the facts and holding in *Avco*, the land use case most often cited for the hard rule that the police power cannot be contracted away. First, it does not appear that the validity of the contract or availability of contract remedies was fully litigated in *Avco*. The parties' briefs, and certainly the decision, focused upon the issues of "vesting" and "estoppel." Additionally, the court found "dubious" the existence of a contract at all.

Theoretically, it may be helpful to conceive of the prohibition against contracting away the police power not as a rule, but as a legal conclusion arrived at after a court in a particular case has conducted the balancing test set forth in *Sonoma*. The test accepts the basic validity of the contract at the time of execution but states that contract terms may be altered without impairment if the public interest in a subsequent conflicting exercise of the police powers is greater than the public interest in the particular contract and long term predictability of public contract relationships. Under this reasoning, the prospects of developer-jurisdiction bargains and contracts being judicially upheld will be increased in proportion to the recognition granted the mounting public interest at stake in these relationships.

In summary, case law suggests that a reasonable, fair, and carefully drafted jurisdiction-developer contract or other form of bargain will be deemed a reasonable exercise of the police power. Furthermore, any subsequent exercise of the police power attempting to nullify or breach such a contract will be subject to strict judicial scrutiny and its purposes balanced against the public interest and policy values in upholding the contract.

3. Building a Foundation for Bargaining.

Because of the potential importance of bargaining in providing capital infrastructure, both the public and private actors ought to utilize every means feasible to bolster their legitimacy. It is suggested that incorporation of some or all of the following measures into the process could increase the prospect of a judicial determination that such arrangements are valid and enhance the integrity of the process as perceived by citizens:

- Inclusion of damages as a remedy in any formal contract;
- Enactment of expanded state enabling legislation; and
- Express incorporation of the bargaining concept and cooperation with the private sector into local ordinances, the general plans, and the local capital improvement plans or programs.

a. *Damages as a Remedy.* Given tight fiscal constraints, many local jurisdictions may be reluctant to include damages as a remedy in contracts with developers. However, as noted by Hagman, *supra*, Vol. 3, No. 10, p. 75: unlike specific performance, "a damages remedy" does not prevent governance or future exercise of the police power. Its inclusion as an alternative remedy for breach bolsters the argument that a particular jurisdiction-developer contract has not contracted away the police power. Indeed, inclusion of a damage remedy might be deemed essential to the validity of the contract. Moreover, one can imagine circumstances in which the jurisdiction would like to have the remedy of damages available for the developer's breach of a contractual bargain. Realistically then, one would expect the parties to negotiate for some mutuality in the form of remedies for breach.

b. Enactment of State Enabling Legislation. A line of housing cases have upheld the validity of contracts entered into by local jurisdictions. These cases involve exercise of planning powers and provision of improvements. *Housing Authority v. City of Los Angeles,* 38 Cal.2d 853, 243 P.2d 515 (1952); *Kehoe v. City of Berkeley,* 67 CA.3d 666, 135 CR 700 (1977).

Although the courts' reasoning is somewhat unclear, in both cases the existence of state legislation authorizing the contract facilitated a judicial finding that the contract was enforceable. See Holliman, *supra*, p. 56-58. The court considered the city to be an arm of the state when acting pursuant to state statute. Therefore, it was neither exercising nor contracting away its local police power. From another perspective it might have been stated that the state statute and legislative preamble or findings established an over-riding state interest which preempted the local police powers and which called for and necessitated long-term enforceability of the contract at issue. Possibly the courts in these cases were implicitly recognizing that certain circumstances may necessitate the present exercise of the police power in a manner that limits its future exercise.

State statutes already authorize the following local jurisdiction-developer agreements: redevelopment disposition and development agreements, the new Development Agreements, and various agreements related to Specific Plan preparation, subdivisions, density bonus inventives, and provision of adequate school facilities. Many of these statutes contain extensive legislative preambles or findings establishing some overriding state interest. Similar new state legislation might help validate other forms of jurisdiction-developer bargaining. The inclusion in such state legislation of policy goals or guidelines and possibly procedures might also address the issue raised immediately below.

c. Inclusion of Goals, Guidelines, and Procedures in a Local Jurisdiction's General Plan, Ordinances, and Capital Improvements Program. The contention that a particular contract or bargain does not illegally contract away the police power might also be more supportable legally if the timing, scope, and duration of the bargain had some basis or reference in existing governmental plans and laws. The General Plan and local laws could expressly acknowledge the present need for such arrangements and possibly set forth objectives, guidelines, and procedures for their proper use. The bargain or

contract would thus implement, not abnegate, general policy. Citizen input into the bargaining process at the early policy stage and the creation of a clear tie to independent planning and budgeting documents would enhance the legitimacy and integrity of the bargains themselves in the eyes of city planners, administrators, the public, and the judiciary.

In addition to generally sanctioning the bargaining process as a means of shifting primary responsibility for providing capital infrastructure, the General Plan or local ordinances might authorize that bargain scope and timing be consistent with the currently adopted capital improvements program. In this regard it is noteworthy that some cities already expressly identify within the capital program those improvements which they expect to be the primary responsibility of future developers.

The development of such a minimum consistency or compatibility requirement for bargains limits the potential for abuse and counters fears that the bargaining process will permit individuals and owners to "buy" local governmental approvals without regard to independent community planning criteria and needs.

In the introduction to their anthology, *The Land Use Awakening: Zoning Law in the Seventies* (1981) pp. 48-49, editors R. Freilich and E. Stuhle identify several basic requirements to be met by land use programs in order to avoid serious challenge in the courts. One of their criteria is "development of, and adherence to a comprehensive plan." Such a plan, they state, carries great weight in a courtroom because it shows that the community has given careful study to the issues involved. Thus the land use program — or in this case the jurisdiction-developer contract or bargain — would not be merely a spur of the moment idea nor based upon improper motivations and considerations. In this regard see *Golden v. Planning Bd. of Rampo,* 30 N.Y.2d 359, 285 N.E.2d 291, 334 N.Y.S. 2d 138, appeal dismissed, 409 U.S. 1003 (1972), where the court found the extensive foundational study and planning a persuasive element in upholding a local growth management program. In upholding municipal actions against anti-trust challenges, the courts have similarly found persuasive the pre-existence of genesis of the policy attacked in the locality's General Plan. See cases cited and analyzed in Strom, Frederic A., "Land Use Controls: Effects on Business Competition," *Zoning and Planning Law Reporter,* Vol. 3 No. 6 (June 1980) pp. 46-47.

With regard to the "bargained for" provision by developers of over-sized or off-site improvements, the state and local governments need to establish a fair, realistic, and relatively consistent scheme for reimbursement or cost-sharing of such expenditures among all the benefited properties. This issue is reportedly among those to be addressed in special hearings before the state Legislature in 1982. At present, state and local enabling legislation regarding procedures for reimbursement and cost-sharing of public improvements is generally vague and imprecise and the procedures actually utilized vary tremendously. Some attention to this issue at the state and local level is essential to achieve among affected property owners some certainty as to probable project costs and overall efficiency in the provision of new capital improvements.

Transfer of Public Administrative and Legal Costs in Land Development Regulation to the Private Sector

In addition to shifting direct responsibility and costs for development of capital infrastructure to the private sector, jurisdictions are also transferring many of the administrative costs of public control of land development to private applicants for development permits. These transfers have been imposed on top of the significant rise in application processing fees since Proposition 13.

The transfer of public planning costs to the private sector can be accomplished in various ways as discussed in Chapter 3. The California Government Code. (Section 66453) provides express statutory authorization for the transfer of the cost of preparing a Specific Plan to the property owners in the planning area. Another example is a jurisdiction's exercise of the option presented by 14 Cal. Admn. Code Section 15061(b) in the official state guidelines implementing the California Environmental Quality Act. That section provides that a jurisdiction may request the applicant for a development permit to prepare and submit a draft environmental impact report (EIR) for "evaluation and use by the jurisdiction in project review." This procedure is an alternative to complete preparation of the environmental documents by the jurisdiction itself or a consultant under contract to the jurisdiction. To date preparation of a draft EIR by the applicant has been disfavored because the adequacy and objectivity of such an environmental document is more readily subject to challenge. Even in the face of such risks, however, some jurisdictions have shifted primary responsibility for preparing the draft EIR and managing the consultant contracts back to the private applicant. A preferred alternative might be to increase the processing fees charged for environmental review and contract administration.

The cost of public litigation expenses and routine public legal services have also become ripe candidates for transfer to the private sector. Already exceedingly complex and time-consuming, the land use regulatory process promises to become even more so as the variety of forms and incidence of jurisdiction-developer bargaining over provision of capital infrastructure increase. Practically speaking, if a developer wishes to secure reasonably prompt action on a project, his attorneys will have to take the lead role in drafting the necessary documents and reports. This course of action is often dictated by simple work overload in the jurisdiction staff. At other times the task may require highly technical legal or other professional expertise not maintained by the local government. Indeed, an applicant's attorneys may even draft suggested findings or proposed ordinances and resolutions.

There are dangers and serious public policy questions raised by increased private attorney assumption of functions historically performed by government. Certainly, the role of the public counsel as advocate and watchdog for the jurisdiction and the public's interest is potentially compromised. A reviewing court and citizenry will scrutinize actions, findings, and agreements of a jurisdiction where the developer's attorney or other technical experts

have played a highly visible role.

This trend has been taken even further by one local California jurisdiction. That jurisdiction rather routinely requires development project applicants, as a condition of project approval, to agree to underwrite the cost and expense of defending and to reimburse the jurisdiction for legal fees sustained in any third party action challenging project approval by the jurisdiction. This practice removes the deterrent value of the law to the degree the jurisdiction officials, staff, and treasury are not held directly accountable for the proper form of their actions. Theoretically, potential liability for improper acts is supposed to restrain public officials tempted to do wrong or abuse their authority. Moreover, it seems inequitable for the developer to be financially responsible for the defense of actions over which he may not or should not have had any control. The integrity of the process in the eyes of the public may be diminished. In the extreme, this practice could provide a vehicle for a wealthy landowner to "buy" questionable development approvals. To the degree a jurisdiction selectively imposes this condition on projects it deems "controversial," it red flags the project for litigious third parties. With regard to devising litigation strategy in third party challenges, this practice poses troubling questions related to potential developer-jurisdiction conflicts of interest and the degree of developer's control of the course of the jurisdiction's defense and conduct in settlement negotiations.

In general, the practice of transferring jurisdiction litigation costs to the private developer seems unwise. Rather, jurisdictions ought to examine their application processing fees and consider incorporating an insurance factor for potential litigation costs into fees for all project applications. Jurisdictions might also seek to expand through state legislation their right to recover attorneys fees from unsuccessful plaintiffs, particularly with regard to unfounded, frivolous lawsuits. One step in this direction has been taken with the recent enactment of California Government Code Section 65914 and California Code of Civil Procedure Section 592.2, which provide for recovery of damages and attorneys fees by prevailing jurisdictions and developers in limited circumstances.

Conclusion

Review of legal issues posed by jurisdiction-developer bargaining reveals substantial authority in support of such a relationship. Nevertheless, the need for more definitive judicial decisions in this area and the wisdom of adopting enabling state and local laws and ordinances is clear. Thus, pending concrete judicial and legislative action sanctioning the new relationship, developers and jurisdictions must consider carefully all of the issues raised above. Where mutual objectives can be accomplished through a less structured form of bargaining than the contract relationship, the parties may wish to opt for the form with less potential for judicial scrutiny or political controversy.

In order to safeguard contracts or other forms of bargains from the charge that the jurisdiction has abnegated its police power, cautious jurisdictions and developers might avoid hard commitments concerning future legislative

acts, which, of course, represent the essence of governmental function. Alternative commitments, for example, might be to expedite future permits, to provide certain services or financial cooperation, or to make adjustments in project conditions of approval or environmental mitigation measures which have been the subject of legitimate debate concerning their necessity or effectiveness.

Special care should also be taken in the course of bargaining not to abridge the unique constitutional and statutory procedural requirements for public notice, hearings, and input that govern quasi-judicial land use decisions such as use permits and subdivision maps. Adherence to such procedural formalities is necessary, not only to withstand judicial scrutiny, but also to obtain meaningful public input and insure the legitimacy of the process in the eyes of the citizenry. On the other hand, formal public hearings are probably best deferred until the terms of a proposed bargain are relatively fully developed or the flexibility required for effective bargaining may be stifled. Rather than rely upon hearings early in the bargaining process, jurisdictions should rely upon their General Plans, general ordinances, and Capital Improvements Programs to establish the outer limits of acceptable bargains and confine the preliminary stages of negotiations. Cunningham (1981) offers further commentary on these issues.

Jurisdiction-developer bargaining is already occurring on a signigicant scale. With increasing recognition of bargaining's positive role in expanding the fiscal resources of local jurisdictions, the time is ripe for judicial and legislative definition and refinement of bargaining use and scope.

10

Policy Choices

The preceding chapters have analyzed the context in which bargaining between jurisdictions and developers is occurring, and argued that this practice will increase in use given the alternatives available for providing the capital infrastructure needed for growth. Such bargaining has been analyzed in terms of its legal bases, the forms it takes, and how it is viewed by the various types of participants to the process. How jurisdictions and developers approach bargaining, and how each is likely to evaluate different forms of bargains was analyzed. The consequences of this strategy, compared with alternatives, were explored in terms of traditional concepts of economic incidence and impacts upon particular institutions. In the immediately preceding chapter, the major legal issues involved in bargaining were the subject of analysis.

Questions remain concerning the present extent of bargaining. Its future use will be influenced by its advantages compared with available alternatives. Given these words of caution, we expect bargaining to become increasingly common over the foreseeable future. The pre-Proposition 13 system of financing infrastructing needed for growth is unlikely to be re-established. Local governments' capacity to raise revenues through taxation is limited. Given the fiscal condition of the State of California (facing a possible revenue shortfall of $2 billion in fiscal 1982-83), increased assistance from the state to local governments is less likely that is a decrease. Indeed, the state is deferring capital outlays itself, which will, in time, constrain growth. Similarly decreases in federal grants-in-aid are more likely than are increases.

The second alternative to bargaining is to sharply curtail development and growth by effectively constraining bargaining very tightly while providing no capacity to increase tax revenues. This alternative is not very probable nor very desirable. It is not probable because the strong pressures for population and employment growth in California would ensure constant efforts to evade, repeal, or otherwise surmount this obstacle — efforts we believe would ultimately prove successful. One reason that efforts to surmount obstacles to bargaining would be successful is because the consequences of no capacity for growth would, we believe, eventually be sufficiently damaging to the state's economy and the well-being of its residents that many would prefer growth. Of course, even at this point, not all jurisdictions would choose to grow, and some should probably not.

Thus we expect bargaining to grow in frequency because it is the

preferable available alternative. If the analyses presented in this volume are largely correct, the consequences of bargaining for the provision of capital infrastructure are acceptable. Jurisdictions and developers prefer this mode of action to the alternatives. The long-term incidence effect, of shifting most of the costs imposed upon developers by jurisdictions to the owners of developable land, is probably preferrable to most citizens and policy makers than the old system in which those interests could receive windfall profits.

Moreover, and very importantly, bargaining need not weaken the capacity of jurisdictions for effective public policy making. A strong capacity for public policy making is fully feasible when bargaining with developers is the primary mechanism by which capital infrastructure is provided. Bargaining can provide opportunity for more effective public policy making than the application of standardized procedures (regarding zoning, dedication requirements, and development fees, for example) by providing opportunity for decision making in the context of a specific project. In such a context, much more accurate judgments may be made about the advantages and disadvantages of the design of a proposed development and about the tradeoffs between design features, financing (including for capital infrastructure) and public policy objectives. Similarly, if real bargaining occurs, rather than the imposition of exactions by governments exploiting monopoly powers over developers, private interests are as likely to be protected as under alternative systems. Existing legal protections of those interests are still in existence.

Also, bargaining is not a wholly new concept; it occurred beween developer and jurisdiction under the old, pre-Proposition 13 system. Large subdivision proposals sometimes led to bargaining under the old system, for example. And redeveloment projects were virtually invariably the product of specific bargaining between jurisdiction and developers. This is one reason that several of the bargaining cases presented in Chapter 5 were redevelopment projects. Bargaining has long been legitimized as the way to accomplish redevelopment, and both jurisdictions and developers approach redevelopment as a process in which effective bargaining is required for success. Explicit bargaining changes power relationships, making the parties more equal because it can occur only with recognition of a mutuality of interest dependent upon joint action.

This chapter is based on the premises that bargaining will become even more frequent and that consequences which are beneficial to both the public and private sectors can be achieved when bargaining provides the capital infrastructure needed for growth. The task undertaken in this final chapter is to examine the policy choices which could achieve such a healthy outcome.

The arguments advanced are based on the belief that most important in ensuring successful bargaining is a facilitative environment for the process. What is needed is a commonly-accepted framework in which jurisdictions and developers may bargain. There is no determinant solution as to what each should give or get, no magical formulas or percentages of the project which must be devoted to one or another policy objective. Indeed, any impulse to require that all bargains adhere to one or another format, include one or another feature, or even to follow a single sequence of procedures, is very likely to be counter-productive.

Two lines of reasoning support this argument. First, not enough is now known about bargaining to provide an adequate basis for restrictive regulation. Facilitation and monitoring are a better strategy. What is needed is an opportunity for learning as the various actors involved in the development process gain expertise regarding bargaining. Moreover, as in any learning process, what some will consider "errors" will be made. Often, such a judgment is but a reflection of differing values or preferences, as may occur when other developers conclude that one of their colleagues has accepted a bargain too costly or risky for their taste. Sometimes, most observers might agree, with hindsight, that a particular agreement between a jurisdiction and developer was ill-considered. Even in these cases, error must be accepted, even embraced, for lessons it provides. Most importantly, the tendency of some officials to respond to "errors" with regulations must be tempered, as regulation writing can as easily create as solve problems.

The second line of reasoning supporting a facilitative, rather than constricting, approach to the development of the legal, political, and economic environment for bargaining is based upon recognition that excessive constraint is antithetical to bargaining. Determinant guidelines for "bargaining" would merely have created a new universalistic set of rules regarding development like those of the old system of tight zoning plus development fees, dedication requirements, and taxes.

Moreover, the reality of many zoning systems is that they induce — or even require — bargaining between developer and jurisdiction, but provide an awkward framework for negotiation. Contemporary zoning plans often mandate, or stimulate, the use of use permits, variances, or other parcel-specific decisions for development. As an example, California subdivision processes, with a two step, "tentative" and "final" parcel map process, give ample scope for parcel-specific policy decisions. Environmental review processes, required on most substantial development projects in California, similarly provide ample room for parcel-specific decisions and bargaining between jurisdiction and developer, as was evident in Chapter 3.

But bargaining is rarely fully legitimized in these approaches to land use policy making. Instead, the common presumption is that the jurisdiction is acting as rule-maker, an image of the process which hampers bargaining by casting the public and private sectors in adversary positions and suggesting that the jurisdiction's decision processes are somehow tainted if "influenced" by the developer. It is but a short distance from this image of appropriate land use policies to cries of "zoning for sale."

Bargaining will be more effective and the public interest better served if it is legitimized. Political legitimacy is one requirement of a facilitative environment for bargaining. Another related but not identical requirement is legality. As the previous chapter argued, bargaining is open to legal challenge but can be structured in ways that are legally defensible. Finally, some stability of the basic framework in which bargaining occurs (particularly the legal grounding, but also the institutional arenas and procedures used) is desirable.

Attention turns now to how bargaining could be facilitated. The discus-

sion starts with the state, then moves to the local jurisdiction, to developers and to financial intermediaries. Throughout, the emphasis is upon establishing a framework that meets two objectives. First, it must provide opportunity for effective public policy-making; the abnegation of public choice over the extent, shape, and pace of the growth that will shape the future of California is not proposed. Second, it must be broadly facilitative of bargaining, providing opportunity for locality and project-specific negotiation, not narrowly circumscribed choice among a limited set of possibilities. Beyond the overall framework, we also explore what each of the roles could do to improve its capacity for effective participation in bargaining.

Policy Choices for the State of California

Given the general theme being advanced of the importance of developing a facilitative environment for bargaining between jurisdictions and developers, the state is critical. As discussed in Chapter 6, the distinctive role performed by the state in the development process is establishment of the institutional framework in which that process occurs. To improve the institutional context for bargaining, the state should:

1: Stabilize the long-term fiscal base of cities and counties.

Bargaining is a response to fiscal stress and uncertainty. The state has increased the gas tax, which will provide additional revenues for the construction and maintenance of streets and roads. But substantial additional tax revenues for cities and counties are not likely in the foreseeable future. While fiscal stress may be a feature of local government finances over the next decade or two, fiscal uncertainty need not. The two primary sources of tax revenue to cities and counties are the property tax and the sales tax and the state should commit itself to maintaining those two sources of revenue in their present form.

Some will argue that should the state, or schools, suffer revenue reductions, the sales and property tax revenues of cities and counties should be tapped to at least partially make up the reduction. Others will contend that increases in these two taxes should be distributed not on the basis of their point of generation, as is now the case, but on some other basis such as a need-biased formula. These impulses should be resisted, for in the absence of predictable long-term revenues (at least as to source) and expenditures (at least as to areas of responsibility), sensible land-use policy making is impossible.

While bargaining can serve to reduce uncertainty, it will be facilitated by underlying fiscal uncertainty. If the basic fiscal system covers post-development service delivery costs and the operation and maintenance of the capital stock, then bargaining can focus upon the front-end costs of capital infrastructure, a dramatically simpler task than covering what may be termed the full "life-cycle" costs of new growth.

2. Simplify and make consistent the policy processes regarding land development.

In the last decade, land development policy processes have become much more complex in California. While the Subdivision Map Act provides a measure of continuity, having undergone only modest change in the past 10 years, that is unusual. The zoning process was substantially altered by the addition of several mandatory elements to earlier requirement for development of a general plan and adoption of a "consistency" doctrine among all parts of the planning process. A decision by the California Supreme Court that the California Environmental Quality Act applied to land use decisions of local governments added a whole new set of procedures and values to those decisions. Local Agency Formation Commissions were formed to oversee local government annexations, boundary changes, and the creation of new entities. Voter approval of an initiative created the California Coastal Commission, a non-local agency to make land use decisions within its sphere of control.

Taken as a whole, the resulting processes are unwieldy and time consuming. The Legislature recognized this effect by passage of AB 884, requiring decision on an application deemed complete within one year of its submission. In AB 893, the vetoed California Communities Act, the Legislature also acknowledged the cumbersome nature of land development procedures by exempting the commission proposed in that act from the CEQA and LAFCO.

Instead of patch-over efforts such as AB 884, which are ineffective, or exempting favored categories of development from the onerous structures it has created as in AB 893, the Legislature should make revisions in the several bodies of statutes governing land development with the goal of developing a simpler, more consistent and more predictable process. As in the previous recommendation, bargaining will be facilitated when its function is to build upon a sound and stable foundation of policy making regarding growth, not to somehow bridge the chasms that exist in the present system.

3. Legitmize bargaining.

Legislation authorizing development agreements has provided express authorization for bargaining between jurisdictions and developers. The experience of legitmized bargaining in redevelopment projects exists. Nevertheless, bargaining is not fully legitimized. Nor are the legal parameters within which bargaining occurs firm.

Legitimacy must be given by the citizenry; if they are suspicious of bargaining, judging it not a fully legitimate process, it will forever be a last resort, awkward mechanism. State policy makers can do little to directly confer legitimacy upon bargaining. They can, however, make bargaining more legal, indirectly encouraging citizens to accept it by making the process more familiar through wider use.

One way of reducing concerns over the legality of bargaining would be to emulate Great Britain. Hagman (1980:78) reports positively on the English

experience with Section 52 of the Town and County Planning Act, 1971, which states: "A local . . . authority may enter into an agreement with any person interested in land . . . for the purpose of restricting or regulating the development or use of the land, either permanently or during such period as may be prescribed by the agreement; any such agreement may contain such incidental and consequential provisions (including provisions of a financial character) as appear to the local . . . authority to be necessary or expedient. . . ."

4. New debt instruments.

Another area where the state can facilitate bargaining is through assistance in the creation of new instruments of debt. A broader, more flexible array of instruments for spreading capital infrastructure costs out over time would facilitate the growth process generally. Debt issuance is particularly critical if jurisdictions are to mitigate the advantages bargaining gives to larger, more heavily capitalized developers. Public sector debt issuance, even when secured by developer or user payments, is likely to allow smaller, less capitalized developers to continue in operation. Debt instruments are also particularly important when land ownership is fragmented, allowing the costs of capital infrastructure to be distributed appropriately among parcel-owners and also, with an instrument to be discussed shortly, to be spread out over time to match the pace of development.

A long-range objective for debt instruments should be to revitalize access to general obligation debt, the instrument appropriate to capital expenditures whose benefits approach a public as opposed to private character. This will require a constitutional amendment to modify Article XIII A of the California Constitution (Proposition 13), an amendment that the electorate is unlikely to approve now but may in the future.

In the closer term, and desirable in any case, is the creation of more flexible procedures for special assessments. Among the options are to specifically authorize the use of such assessments for a broader range of purposes, including, for example, facilities for police, schools, and other services. Also being considered, although of uncertain legality, is the use of special assessments for the operation and maintenance of any public facility or item of capital infrastructure. One area of current legislative interest is in making the procedural steps required for the creation of special assessment districts, including those for approval, more uniform. This may be desirable, if the move to standardization does not make the creation of assessment districts more difficult.

Another idea, advanced by Professor Donald Shoup, is to allow deferred payment special assessments in which payment of the assessment (plus accrued interest) would be deferred until the parcel upon which the assessment was a lien was sold. This would presumably encourage landowner approval of special assessments, as their repayment would be eased by coming at the time of sale of the property, when cash should be more readily available. While worthy of serious consideration, this proposal illustrates nicely a con-

straint which must be accommodated in developing new instruments of debt issuance.

That constraint is found in the financial markets, where the debt must be underwritten and sold. About $100,000,000 in special asssessment bonds were issued by California local governments in the last year. Some experts believe twice that volume will be issued in 1982, others believe the figure will be even higher. The ultimate constraint upon the volume of special assessment bonds issued will be buyers. At present, most special assessment bonds are placed with private individuals seeking secure tax exempt income over a fixed term. There is no organized secondary market for the bonds.

A deferred payment special assessment bond does not fit the present market for special assessment bonds. No matter that the probabilities of property turnovers predict timely cash flow to retire the bonds, the certainty of specified payments has been lost. To market a deferred payment bond will require substantial efforts to find buyers interested in such an instrument, and might well require the invention, legalization, and marketing of new instruments (where repayments were regularized by reserve funds or the guarantee of a financial intermediary, for example) or new investment devices (such as a pooled, money market fund-like packaging of special assessment bonds).

The general point is that policy makers must work closely with financial institutions, particularly with those financial intermediaries involved in the underwriting and placing of government debt, to ensure that marketable instruments are developed. That industry has demonstrated an ability to develop and successfully market new instruments, and there is no reason to doubt that it is willing to work closely with policy makers in meeting the needs of California governments for debt. But, like any other complex, long-established institution, the financial markets have values, traditions, and legal constraints which shape what they can do. In the short-run at least, policy makers must work within these constraints.

A final issue regarding debt issuance concerns the newly created California Debt Advisory Commission (Government Code Section 8855). Essentially a "sunshine" process through which the details of any local government debt must be made public at least ten days before issue, several benefits could be realized from this new activity. Local jurisdictions will be able to compare what it costs them to bring an issue to market (in fees for financial advice, underwriting, and bond counsel). Large issues may be better timed, so that they do not compete directly with each other. Both local governments and investment bankers worry about how the Debt Advisory Commission may evolve over time. Some local officials fear that state members of the commission will be unsympathetic to their needs for debt. Some investment bankers fear that the commission will impose needless regulation on their activities. In this regard, they cite as an example the restraints imposed by the state in authorizing only four firms to underwrite debt for health facilities. One specific danger to be avoided is that the state, whose officials will dominate the commission, could seek to ensure that its issues come to market at the best terms. This need not occur, and individuals close to the new commission avow that it will not, but if it should, the consequences would not

be desirable. In the first place, the state typically issues only about one-half as much debt as does local government, so higher total costs to California taxpayers could result. Second, if local officials and the financial markets come to distrust the commission, it will be unable to fulfill its possibly beneficial role, which needs the cooperation of those actors.

5. Provide state-financed or controlled capital infrastructure in a timely and reasonable fashion.

Some major items of capital infrastructure critical for the future growth of California are financed or otherwise controlled by the state. Included are freeways, state highways, and the State Water Project. Already investing less in capital infrastructure than the national norm before passage of Proposition 13, state capital expenditures have been further depressed since then. In time, this situation must be remedied.

As important as the dollar amount of capital infrastructure provided by the state is its timing and nature. The state's policy decisions in this area are influential. Freeways shape growth patterns and so too do water projects. Anecdotal evidence suggests that some state decisions (regarding freeway design, for example) are currently being made according to judgments as to where growth should occur. But there is no (evident, at least) conscious planning for all capital activities of the state. One alternative that could be explored through such a planning process would be the desirability and feasibility of encouraging growth in designated areas. Close attention to the experience of European nations which have tried to influence locations of industry and populations and close cooperation with relevant local officials and the private sector would be important to the success of this strategy.

These five policy choices by the state would facilitate policy making concerning growth in California and provide a more supportive environment for bargaining. They do not, themselves, require any particular level of growth. They do maintain fully the capacity for effective public policy making concerning the extent, character, and pace of growth in the state.

It is important to recognize that the state, if behaviors of all three branches of state government over the past decade are any guide, will not easily embrace these suggestions. These recommendations are based on the premise that the state' appropriate role in growth is to be facilitative of the needed processes, shaping that growth broadly, but relying largely upon decisions made by local jurisdictions, private firms, and individuals. To do so, state policy must recognize the needs and constraints of those other actors and its own limited powers.

This is precisely what has often been lacking over the past decade. Only the state could have resolved the mounting public concern with taxes before Proposition 13 was passed, but the Legislature was paralyzed. Since passage of Jarvis-Gann, the state has not re-established a stable fiscal base for cities and counties, leaving them in the untenable position of making land use deci-

sions with long-term fiscal consequences with no certainty as to their future revenues or expenditures. Splashy, large-scale interventions, such as the California Communities Act, pass in the Legislature, while the onerous underlying legal framework for making land use decisions remains unexamined.

Most of the legislation considered dealing with growth focuses upon the provision of housing for households of low and moderate income, especially for the elderly and as rentals. This orientation so dominates policy making in both the executive and legislative branches that virtually no attention is given to the effects of the present crazy-quilt land development procedures and anti-growth sentiment in escalating the price of housing in the state to well above the national average. In effect, the state pursued "gush-up" policies in the past several years, sufficiently depressing production of housing and encouraging building of expensive units that households with higher incomes or those willing to devote higher percentages of their incomes to housing bid up the price of available units. The consequence of these policies is that Californians spend 37% of their personal income on housing compared with a national average of 24%, a "tax" of some tens of billions of dollars annually. The state Supreme Court has contributed to making land use policy making cumbersome by a long series of decisions which were not only anti-growth, but which also introduced increased uncertainties in the development process by delaying project vesting until an extremely late point in the process (substantial reliance upon the last discretionary public decision) and broadening the bases of challenge to decisions made by local jurisdictions (Dimento, et al., 1980).

While recognizing the difficulty state officials are likely to have in recasting their role along the lines of the recommendations we have advanced, we still believe they should be put forward. This analysis argues that they are sound, at least in general thrust. Moreover, they are likely to be more readily acceptable over the next few years. Fiscal stress is likely to continue, but so too will pressures for growth in both jobs and population. Present policies are ill-equipped to handle these twin pressures. In time, the pressures are likely to be so powerful that attitudes as to how effective policies may be made will change.

Policy Choices for Local Governments

While only the state government can fundamentally alter the framework within which land development occurs, California local governments can improve their capacity to bargain within the existing framework. Some jurisdictions will choose not to grow and will have little interest in bargaining. Cities and counties which want growth should not fear being aggressive and entrepreneurial in pursuing their growth-related policy objectives. They can maintain as firm control of their destinies through closer partnerships with the private sector as they exercised under the pre-Proposition 13 system, perhaps even becoming more effective policy makers. Among the steps they can take in this direction are the following:

1. Define goals regarding growth desired by the jurisdiction and pursue these goals aggressively.

Jurisdictions without goals as to their future growth are unlikely to shape that growth or to bargain effectively. Of course, most jurisdictions in California have adopted General Plans which purport to state their goals. But few of these have been reviewed and modified to reflect the impacts of Proposition 13 upon the fiscal situations of the jurisdictions. And few jurisdictions have fully exploited *available* mechanisms for handling whatever growth they do desire through as sensible a policy process as is possible. For example, relatively few jurisdictions appear to have prepared master environmental impact studies on the areas where they desire growth, a step that expedites the process and would make the "mitigated negative declarations" negotiations described in Chapter 9 technically easier. Such efforts would also provide the elected officials and citizens of the jurisdiction opportunities to understand and make policies concerning major trade-offs, facilitating subsequent bargaining.

This recommendation is not intended to provide employment for a cadre of consultant planners. Their services may well be needed in some cases, as may those of individuals more familiar with development finance. In many instances, however, what is needed is not the amassing of new technical data but adjusting choices previously made to the new context. Where new studies are needed, use of the specific planning process should be considered.

Beyond planning as a paper and ordinance exercise, most jurisdictions can be more aggressive about achieving what they have planned. To a very large degree this requires their developing a more entrepreneurial attitude than they now commonly exhibit. Instead of waiting for projects to be proposed, jurisdictions could more actively solicit desired development. Where they do not want development or have very explicit preferences as to what shape or timing growth should take, they should make that unambiguously clear to affected property owners and to developers.

2. Develop explicit procedures for bargaining.

Without precluding adaptation to specific cases, jurisdictions should develop explicit procedures regarding bargaining. As argued in Chapter 9, this can reduce the likelihood of legal challenge. It can also alleviate the sort of citizen befuddlement, alienation, and outbursts discussed in Chapter 6. In addition, developers will benefit from knowing the ground rules for negotiation.

Among the steps that jurisdictions could take regarding bargaining are both those that are purely procedural and those which are more substantive. As examples of procedural steps, the jurisdiction could establish a formal staff bargaining team, consisting, for example, of senior individuals from the planning department, the finance office, the manager/administrator's office, and legal counsel. Understandings as to when elected officials were to be involved could be developed. So too could liaison relationships and working decision rules with other local entities (such as schools and special districts) likely to be affected.

As an example of a more substantive "procedure," the jurisdiction could have decided in which areas it wishes to use special assessments or other financing instruments. These decisions, it will be remembered, are particularly important where land ownership is fragmented and when the jurisdiction seeks to preserve opportunities for less highly capitalized developers. Even more substantively, the jurisdiction can develop a "capital budget," which identifies all capital projects needed to implement its planned growth, making judgments about which can be required for development of individual (usually large) parcels, where some sort of assessment district is needed, and where the jurisdiction will have to find funds within its budget. Ideally, jurisdictions should develop and promulgate performance standards of sufficient specificity that developers, neighbors, and public officials would have reasonably accurate expectations as to what bargaining would be likely for development.

3. Develop competence to bargain.

Successful bargaining requires competence. Most obviously, expertise is needed in the variety of legal, engineering, and economic analysis tasks required to conclude a successful bargain. If the jurisdiction does not now have these competencies among its staff, it should identify individuals or firms to whom it can turn as consultants for assistance.

Beyond technical competence, bargaining also requires political capacity. Arguments suggested in Chapters 6 and 9, bear mentioning again. Efforts should be made to plan for bargaining and to construct an environment in which negotiations are entered into with positive expectations that public policy objectives will be achieved and private property rights protected. Every effort should be made to reassure citizens that bargaining does not subvert public policy. The formal steps suggested earlier of developing formalized procedures and inclusion of this option in the general plan and other relevant official documents will help in this regard. Ultimately, however, the legitimacy of bargaining will be the result of how well it functions. Conflict is virtually always involved in land development decisions, so unanimity regarding bargaining is unlikely. But officials can do much to make visible their careful attention to public policy objectives and private rights throughout the bargaining process, thereby at least reducing the plausibility of charges of impropriety.

This discussion of what local jurisdictions can do to improve their ability to succeed as bargaining becomes even more frequent is, in one sense, unremarkable. A few jurisdictions have been following these suggestions for some time, and they echo others' recommendations as to how cities and counties should approach creating the future they desire for themselves.

But there are very few jurisdictions which comply with these recommendations. The primary barrier to moving more fully in these directions is attitudinal. Local public officials too frequently see themselves in an adversarial role to developers. Simultaneously, they often believe themselves unable to shape the future of their communities, sometimes preempted by federal or state policy, often short of fiscal resources, mistrusting developers, and fearful of citizens. More open bargaining with developers in the context

of seeking to achieve their public policy objectives is unlikely to wholly cure this list of ills. But it does provide a mechanism by which to seize fuller control of the growth of their communities. As local officials see other jurisdictions succeeding with these devices, they will be drawn to them as the best available alternative.

Policy Changes for Developers

To some developers, perhaps even many, the theme advanced in this volume, that bargaining is preferable to the available alternatives, is distasteful. Negotiations with jurisdictions over how much of the costs of capital infrastructure they should bear is one more source of uncertainty and threat to their profits. From their perspective, they have enough difficulties. High and volatile interest rates kill projects at the planning stage, drive up construction costs, and make it difficult to sell completed projects. Loans are often difficult to arrange, even if the interest rate quoted is acceptable. And some lenders seek equity participation as a way of increasing their yields from loans. While the analysis of incidence effects of a shift to bargaining in Chapter 8 argued that developers would ultimately pass increased costs back to landowners, this is small solace to the developer presently holding land or not desirous of moving to another jurisdiction, or even out of state.

Until behaviors can be adjusted to the new rules of the land development game, developers are vulnerable, and some will undoubtedly suffer substantial economic losses. As they seek to adjust to bargaining, the following four recommendations are worthy of consideration.

1. Move rapidly to push increased costs and risks back toward the landowner.

As the developer community realizes that the increased costs imposed by local jurisdictions can be (according to the analysis of Chapter 8) pushed back to the landowner, they should move aggressively to do so. This will, of course, be resisted by the landowner.

Where possible, developers may wish to make the purchase price of parcels they acquire contingent upon the bargain they ultimately strike with the jurisdiction. While landowners are likely to resist this, purchase agreements involving options to be exercised contingent upon specified public policy decisions (such as rezoning) are quite common, so precedent exists for such a strategy.

2. Encourage jurisdictions to legitimize bargaining.

A second recommendation is that developers actively encourage jurisdictions in which they operate even occasionally to legitimize bargaining. All of the recommendations in this vein given above for local jurisdictions should be urged upon them by developers.

The argument behind this recommendation is simple. Uncertainty, time delays, and political risk are more damaging to the interests of developers

than are higher costs. If anticipated, the latter can be accommodated in the proposed project or, if too heavy a burden, the project killed at its inception.

3. Develop the expertise and resources needed for bargaining.

Just as local jurisdictions will need to develop new expertise and resources in order to bargain effectively, so too will developers. By and large, the expertise needed is identical, including legal, economic, and engineering skills. In addition, developers may find a need for added expertise on the local political situation. As was the case for local jurisdictions, developers need not have this expertise on staff. They may hire knowledge.

Chapter 9 discusses situations where local jurisdictions, lacking available expertise, rely upon the developer's experts. This is largely undesirable from the perspective of the jurisdiction. From the perspective of the developer it often expedites consideration of the proposed project and may even be unavoidable. In the long run, however, developers are probably advantaged by encouraging jurisdictions to develop their own expertise as this reduces the potential for charges that the developer and jurisdiction have committed some impropriety.

4. Seek to preserve opportunities for smaller, less capitalized developers.

While not in the immediate self interest of larger developers, most developers would benefit from preservation of opportunities for smaller, less capitalized operations. First, of course, many developers are in this category. Moreover, developers of different scale commonly seek projects of a scale that matches their resources. Shapell or Cadillac-Fairview are unlikely to build a 20-house subdivision and Rouse or Hahn are unlikely to build a modest neighborhood shopping center.

In pursuit of this objective, developers should work closely with local jurisdictions and lobby the state to create a variety of public policy instruments that allow the costs of large capital infrastructure projects to be apportioned among many parties. They have, it is obvious, an interest in the broadening of assessment bond financing.

This list of policy recommendations shows how precarious is the position of the developer as the rules of land development change. Increased costs and risks must ideally be pushed back to the landowner. If that is not possible, efforts will be made to push them to other potential bearers, as explored in Chapter 8. At the same time, jurisdictions need to be encouraged to legitimize bargaining and to avoid adopting policies which favor large, well-capitalized development firms.

Policy Choices for Financial Intermediaries

The final perspective to be considered is that of the financial intermediaries, those who underwrite debt. The policy recommendation is quite

obvious: new instruments of debt are desirable. As stated earlier, new instruments are being created, so the public securities industry is already moving in this direction.

Given the depressed level of new issues in California in the recent past, it would appear that the market would have considerable capacity to handle more debt. But volatile interest rates have made many buyers wary of long-term fixed return investments such as bonds, and the demand for municipals may be depressed until uncertainty about long-term interest rates and yields is quieted. The other factor affecting the total capacity of the market to absorb new municipal offerings from California local governments is that the traditional instrument, the general obligation bond, well-understood by purchasers and with secondary markets, is withering away.

Thus, financial intermediaries need to fashion new instruments (or increase use of old instruments such as revenue bonds or special assessment bonds) which can provide the financing needed for growth and to develop new markets for these instruments. This is a substantial, critical task. As suggested above, state policy making is important in this endeavor and close collaboration between public officials, both state and local, and the financial intermediaries is mandatory if this challenge is to be met.

There is no neat conclusion to an analysis such as this. Bargaining is increasing as jurisdictions and developers seek to provide capital infrastructure needed for growth. All Californians, those now resident and those who may be resident in the future, have a tremendous stake in this process. Bargaining can meet much of the need for capital infrastructure. The consequences of following this strategy are acceptable. The incidence effects in the long run are, we believe preferrable to both the old system of financing public works and are certainly preferrable to the no-financing, no-growth alternatives. Moreover, the capacity of local jurisdictions to shape their futures through effective public policy making is maintained. So too can the long-established safeguards of private property rights be at least as well protected as under alternative systems of land development. But bargaining is a practice undergoing creation, not yet so widespread as to be *the* system for financing capital infrastructure, and sufficiently fragile that it could be constrained. We believe it should be nurtured.

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