

Redevelopment and the Property Tax Revenue Debate

In California, redevelopment agencies (RDAs) receive over 8 percent of all property taxes collected in the state every year. In FY1994–1995, this amounted to \$1.5 billion. In a state where local government revenues are severely constrained by tax limits, this allotment of property tax revenues is a matter of intense policy debate. Much of the controversy revolves around *tax increment financing*. Once an RDA forms a project area, most of the increase in property taxes in that area goes to the RDA. The rationale for this is that the RDA's improvements in the area are responsible for rising property tax assessments. However, general economic trends could also be contributing to the increase in property values. If so, the tax revenue diverted to the RDA from the county, school districts, and other local entities could be characterized as an involuntary subsidy.

It may be that state policy goals for redevelopment are well served by this subsidy and that other taxing agencies can legitimately be expected to provide it. However, that question cannot be resolved without hard evidence about the size of the subsidy. In *Subsidizing Redevelopment in California*, Michael Dardia examines the purpose, incentives, and operations of RDAs, estimating for the first time how much of the property tax revenue that RDAs receive results from their activities.

Origin and Operation of RDAs

Redevelopment agencies grew out of federal urban renewal programs of the 1940s. The California Community Redevelopment Act of 1945 authorized any city or county to establish an RDA to combat urban blight. Today, California has 351 active RDAs with over 700 projects under way, virtually all of which are run by city agencies, although 15 counties also have active RDAs. The agencies engage in a wide variety of activities—purchasing property, razing and building structures, providing municipal infrastructure such as streets and lighting, developing affordable housing, and renovating downtown commercial areas.

More than half of the RDAs in the state were created after the passage of Proposition 13 in 1978. The fiscal austerity imposed on local governments made the tax revenues available to RDAs more attractive than ever. An RDA receives the property tax increases in a project area for the life of a project—often 30 years or more. Without the project, the property tax revenues would be shared among counties, cities, schools, and special districts.

Recognizing the strain that tax increment financing could cause other local jurisdictions, the state legislature allowed them to negotiate with RDAs to recover some of the tax increment. These payments, called pass-throughs, were negotiated project by project. The RDAs, on average, shared about 14 percent of their tax increment with other jurisdictions in FY1993–1994, with counties receiving about two-thirds of the money. School districts had little incentive to fight for the pass-throughs because the state reimburses schools for any lost property tax revenue. This reimbursement amounts to hundreds of millions of dollars each year, and these costs, along with perceived abuses in the designation of blight, led to reform legislation, AB 1290, in 1993. AB 1290 set a uniform pass-through rate of approximately 33 percent for new projects. This was an implicit recognition that the subsidies flowing to RDAs were too large. However, no estimates of the size of these subsidies existed, so the size of the adjustment relied more on political judgment than on empirical evidence.

The Redevelopment Study

This study sought to answer two questions raised by critics of redevelopment: How blighted are project areas, and how much are RDAs subsidized by tax increment financing? The study focused on redevelopment projects initiated between 1978 and 1982 (the first five years after the passage of Proposition 13). The initial study sample included all counties that started at least three projects within this five-year period. Ten counties with 114 projects met this criteri-

on. Each RDA project area was matched to a Census Block Group in the same city that was similar to the project in terms of poverty and vacancy rates but was not part of any redevelopment project. To evaluate the effect of RDA activities on property values, Dardia compared the change in assessed value for the project areas and the matched areas from 1983 to 1996. Data limitations ultimately led to a final sample of 38 projects in three counties (Los Angeles, San Bernardino, and San Mateo). However, these projects were very similar to the 114 projects in the original sample, so the results from the final sample can be reasonably extrapolated to the original 114 projects.

Findings

Although there was considerable variation among projects, the average vacancy and poverty rates were higher, and median incomes and median rents were lower, in the project areas than in the rest of the city. However, the extent of blight identified varied greatly among cities, and some RDAs declared that most of their city was blighted. Also notable is that many of the project areas included vacant land: In 20 of the 114 projects, more than 50 percent of the project area was vacant land, suggesting that some RDAs were engaging more in development than redevelopment.

The more critical question this study sought to answer was how much of the property tax revenues the RDAs received was due to their effect on local property values. Overall, the sample projects retained almost 84 percent of these revenues, with other taxing jurisdictions receiving 16 percent. Thus, in aggregate, property values in the project areas should have grown more than six times faster than their matches to account for the amount of tax increment they received. As shown in the figure, only four project areas grew fast enough to justify the RDAs' claim that they were solely responsible for the increase in property taxes.

In dollar value, the 38 projects collectively received \$78 million in tax increment revenues, about \$40 million of which can be explained by the RDAs' effect on property values. Thus, the subsidy from other jurisdictions to the RDAs totaled \$38 million in FY1994–1995.

Conclusions and Recommendations

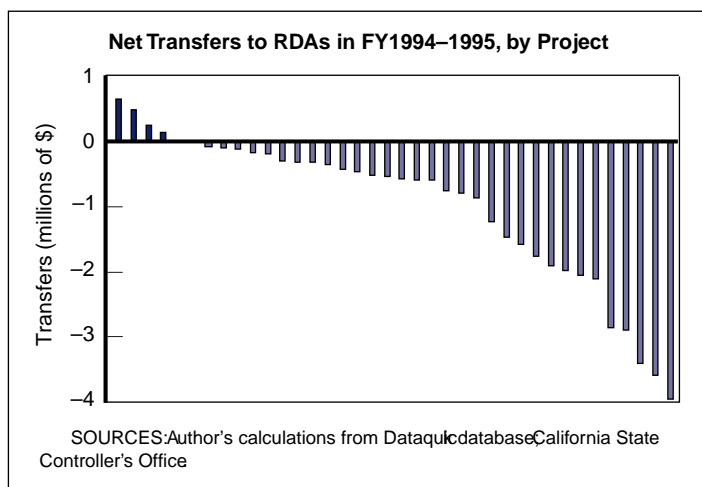
The value placed on redevelopment projects' achievements may outweigh concerns about whether RDAs are heavily subsidized. Nonetheless, it is important to know

how much one level of government is subsidizing another so that competing uses for public dollars can be fairly considered.

This study's results suggest that the existing tax increment system is not an effective way to finance redevelopment. Few projects generate enough increase in assessed value to account for their share of these revenues, and those projects that came closest defined blight broadly and included large amounts of vacant land. Tax incentives can lead cities to designate too many areas as blighted, and if true blight is targeted, an area is unlikely to generate enough revenue to earn the tax increment revenues.

The study makes four recommendations to state lawmakers that should help resolve the controversy surrounding redevelopment:

1. The legislature should formally clarify the goals of redevelopment.
2. The definition of blight should be aligned with the goals of redevelopment and should be made more precise.
3. Some form of oversight authority should be established to monitor RDA behavior.
4. If the legislature intends redevelopment to be self-financing rather than heavily subsidized, the pass-through rate should be increased significantly.



In "balancing the books" on tax increment financing, the study found that most projects did not generate enough growth in assessed property values to account for the tax increment they received.

This research brief summarizes a report by Michael Dardia, Subsidizing Redevelopment in California. The report may be ordered by calling (800) 232-5343 [mainland U.S.] or (415) 291-4415 [Canada, Hawaii, overseas]. A copy of the full text is also available on the Internet (www.ppic.org). The PPIC is a private, nonprofit organization dedicated to independent, nonpartisan research on economic, social, and political issues that affect the lives of Californians.
