R SHEET ON

REDEVELOPMENT REVIVAL IN CALIFORNIA

March 2020

BACKGROUND

In the midst of nationwide concerns about festering slums, California in the 1940s created redevelopment agencies to give local governments creative financial tools to battle urban blight. This system quickly morphed into a financial gimmick that localities used to fund projects that often had little to do with urban renewal. It primarily became a means to bolster their general funds, allowing them to divert property taxes from traditional public services—like schools and police and fire departments—to fund development projects that created sales-tax windfalls.

Here's how the process worked: Redevelopment agencies used a technique called "tax-increment financing" to pay for improvements in project areas targeted for new development by city officials. The local agency would first find "blight" in a specified area. It would then sell bonds—without public approval—to pay for infrastructure and land acquisition for the proposed new development. Finally, the agency would collect the "tax increment"—an increase in property taxes levied after project completion—to pay off the bond debt. The agencies were required to spend 20 percent of the proceeds on affordable housing projects.

Unfortunately, the standards for state-required blight findings were broad enough to invite abuse. Redevelopment officials became remarkably creative in the search for blight. For instance, one rural vacation town declared its downtown area blighted because of excess urbanization—a claim so questionable it earned a rare court rebuke. The agencies' blight reports virtually always justified the proposed project. Once an agency found blight, it gained broad powers to subsidize agency-picked developers and seize property through eminent domain. Some agencies turned entire cities into blighted redevelopment areas. The process became an egregious example of crony capitalism.

Redevelopment proponents often point to the revival of Old Town Pasadena, the San Diego Gaslamp Quarter and some other now-bustling areas as examples of the system's value, but those areas are outliers (and ones likely to redevelop on their own, given their prime locations in upscale cities). Typically, agencies preferred to fund big-box stores, movie theaters, hotels and other attractions that would provide sales and bed taxes. The bonds funded the projects, the new property-tax revenues paid off the bonds and the cities lured commercial developments that would provide them with discretionary funds—i.e., money they could use any way they chose. This was a prime motivator for cities that long claimed to be strapped for cash.

SUMMARY

- Redevelopment agencies were created in the 1940s to fight urban blight, but morphed into a way for local governments to divert property tax dollars from traditional services.
- These agencies routinely abused eminent domain by taking private homes and businesses and giving them to developers who promised tax-generating projects.
- Gov. Jerry Brown shuttered the agencies in 2011 as he sought to fill a budget hole.
- Last year, Gov. Gavin Newsom cited fiscal concerns in vetoing SB 5, which would have tapped $2 billion a year and increased affordable housing earmarks to 50 percent.
- A similar bill, SB 795, has been introduced this year. Given recent economic concerns, lawmakers should reject this latest redevelopment revival.

Under redevelopment, tax-increment proceeds came out of the budgets of counties where these cities were located. Redevelopment also siphoned cash from public schools. But the state was required to backfill those dollars under Proposition 98, which guarantees schools approximately 40 percent of the state's general fund revenue. In the midst of the 2011 budget-deficit crisis, then-Gov. Jerry Brown shut down the state's 400-plus redevelopment agencies as he searched for revenues to plug a massive budget hole. By that time, redevelopment agencies had diverted 13 percent of California's property taxes as part of the backfilling process.

In a 2005 decision, the U.S. Supreme Court allowed cities to take private property for a public "benefit" in addition to public "use." Public benefits are wide-ranging and can include anything that arguably would benefit a locality, whereas public uses are restricted to publicly owned facilities such as roads and courthouses. After that ruling, many other states—at the court's encouragement—reformed their property seizure laws. California passed only a superficial reform, leaving property owners in peril as long as redevelopment existed – or if it comes back in a similar fashion.

CURRENT DEBATE

In the nine years since redevelopment's demise, the economy grew and the general-fund budget maintained a hearty surplus. Because the state shuttered the agencies for financial rather than philosophical concerns, there's been little Capitol resistance to reviving redevelopment in some form or another. Gov. Brown signed a handful of laws that incrementally recreated redevelopment-like districts. Those Enhanced Infrastructure Financing Districts have limited powers, however, and cannot unilaterally divert money from counties.

Other legislative measures have tried to rebuild redevelopment as it previously existed. Last year, the Legislature defeated one such bill, but approved another that would bring the process back in a different form. That measure, Senate Bill 5, was promoted as a means to deal with the state's housing-affordability crisis. Authored by Sen. Jim Beall, D-San Jose, it would have created a $2 billion annual fund to pay for housing and community development projects, with half of the money earmarked for housing projects. Unfortunately, the legislation would have opened the door to the same property-rights abuses and distorted financial incentives that existed under the shuttered redevelopment agencies.

Specifically, the bill would have created a state committee to approve projects proposed by local agencies. Given last year's budget surpluses, the League of California Cities argued that "the time is right for the state to restore more robust financing mechanisms." Gov. Gavin Newsom noted the severity of the housing crisis, but vetoed the measure. "Legislation with such a significant fiscal impact," he wrote, "needs to be part of budget deliberations so that it can be considered in light of other priorities." The time wasn't right then, and it's an even worse time for this bill now.

Beall is back this year with Senate Bill 795. It's essentially the same legislation as Senate Bill 5, but with a slower ramp-up and a provision that allows the state to suspend new projects in the midst of a budget crisis. That rule is window-dressing, because the state would still have to fund previously approved projects. The bill places no serious restrictions on the use of eminent domain for private projects.

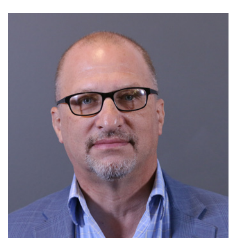
California can't afford to tie up $2 billion a year in new spending, made evident by the coronavirus-related financial meltdown. The state does have a serious housing crisis, but the solution is to reduce the myriad government regulations and fees that drive up housing costs and depress supply. The state cannot subsidize its way out of housing shortages. Eroding property rights will only compound the problem by discouraging individuals from investing in rental housing.

ACTION ITEMS

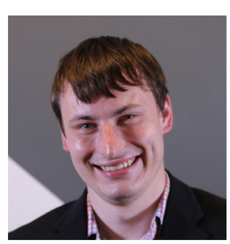
In light of serious fears of recession, California needs to do what Gov. Newsom and Brown have both suggested: build up its rainy-day fund and resist creating costly new programs that permanently tap the general fund and thereby limit the state's flexibility if its capital-gains-dependent revenues start to fall. The stock market dropped dramatically in mid-March, so such warnings are more timely than ever. Lawmakers should reject SB 795 when they return to session.

CONTACT US

For more information on this subject, contact the R Street Institute, 1212 New York Ave. N.W., Washington, D.C. 20005, 202-525-5717.



Steven Greenhut
Western Region Director
and Senior Fellow
sgreenhut@rstreet.org
909-260-9836



Nick Zaiac
Resident Fellow,
Transportation and Infrastructure;
Commercial Freedom
nzaiac@rstreet.org
202-525-5717