February 4, 2014

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative related to the reactivation of redevelopment agencies (RDAs) (A.G. File No. 13-0065, Amendment #1-NS).

BACKGROUND

Property Taxes and Redevelopment

Property Taxes Are Allocated to Local Governments. Californians pay around $50 billion in property taxes annually. County auditors distribute these revenues to local governments—schools, community colleges, counties, cities, and special districts—pursuant to state law. Property tax revenues typically represent the largest source of local general purpose revenues for these local governments.

RDAs Were Established to Address Urban Blight. In 1945, the Legislature authorized cities and counties to create RDAs. Several years later, voters approved a redevelopment financing program referred to as "tax increment financing." Under this process, a city or county could declare an area to be blighted and in need of urban renewal. After this declaration, most of the growth in property tax revenue from the project area was distributed to the city or county's RDA as "tax increment revenues" instead of being distributed as general purpose revenues to other local governments serving the area. Under law, tax increment revenues could be used only to address urban blight in the community that established the RDA.

Growth of Redevelopment Prompted Legislative Changes. During the 1950s and 1960s, few communities established redevelopment project areas and most project areas were small. However, beginning in the 1970s, largely as a result of two major state policy changes—Chapter 1406, Statutes of 1972 (SB 90, Dills), which guarantees each school district an overall level of funding from local property taxes and state resources combined, and Proposition 13, which significantly constrained local authority over the property tax—use of redevelopment significantly expanded. Beginning in the 1980s and increasingly through 2011, state lawmakers took actions to constrain local governments' use of redevelopment. These actions included tightening the definition of blight,

limiting the amount and timeline of property tax diversions for redevelopment, and prohibiting new projects on bare land. The Legislature also enacted laws strengthening the statutory requirement that RDAs spend 20 percent of their tax increment revenues developing housing for low- and moderate-income households.

Redevelopment Received Significant Portion of Property Taxes. In 2010-11, over 400 RDAs received about $5 billion in property tax revenue statewide—a redirection of 12 percent of property taxes. In the absence of redevelopment, over $2 billion of these property tax revenues would have been allocated to school and community college districts.

Legislation Enacted Ending Redevelopment. Chapter 5, Statutes of 2011 (ABX1 26, Blumenfield), enacted in June 2011, imposed an immediate freeze on RDA authority to engage in most of their previous functions, including incurring new debt, making loans or grants, entering into new contracts or amending existing contracts, acquiring or disposing of assets, or altering redevelopment plans. The bill also dissolved RDAs, effective October 1, 2011 and created a process for winding down redevelopment financial affairs and distributing any net funds from assets or property taxes to other local tax agencies. (Court actions changed the date of RDA dissolution to February 1, 2012.)

Former RDA Property Taxes and Other Resources Are Distributed to Affected Local Governments. As the operations of former RDAs wind down, their resources are being redistributed to other local governments. These resources include (1) property tax revenue not needed to pay RDA debts and pass-through payments to local governments, (2) unencumbered RDA cash and other liquid assets, and (3) proceeds from the sale of some former RDA real estate holdings. County auditor controllers distribute these RDA resources to local agencies in a manner similar to how they distribute property tax revenues. In the current year, local governments will receive about $1.85 billion that would have been available to RDAs, absent RDA dissolution. Schools and community colleges will receive over half of this total. Over time, these distributions to affected local governments will increase as former RDA debts are paid. Most of the RDA resources provided to K-14 districts offset required state General Fund education spending, thereby creating savings for the state.

State Controller's Office (SCO) Tasked With Recovering RDA Assets Transferred to Other Entities. Prior to dissolution, many RDAs took actions to transfer redevelopment assets—land, buildings, and parking facilities—to other local agencies, typically the city or county that created the RDA. Assembly Bill X126 assigns SCO responsibility for recouping redevelopment assets inappropriately transferred during the first half of 2011. Specifically, SCO is directed to determine whether the RDA transferred an asset to the city or county that created it (or to another public agency). If the asset has not been contractually committed to a third party, "the Controller shall order the available asset to be returned" to the successor agency.

Redevelopment Funds Often Were Used to Benefit Sponsoring Local Government. Frequently, the RDA sponsoring government (a county, or more often, a city) established financial agreements for the purpose of reducing its costs or increasing its revenues. For example, many RDAs paid a significant share of their sponsoring local government's administrative costs (such as part of the salaries for the city council and city manager). Doing so freed up city or county funds so that they could be used for other purposes. Some RDAs also lent money to their city or county without charging interest on the loans, allowing the city or county to invest the funds and keep the earnings.

Other sponsoring governments charged their RDAs above-market interest rates for loans, thereby allowing the city or county to benefit from unusually high interest earnings.

Schools and Community College Finance

Proposition 98 "Minimum Guarantee" for Schools and Community Colleges. State budgeting for schools and community colleges is governed largely by Proposition 98, passed by voters in 1988. The measure, modified by Proposition 111 in 1990, establishes a minimum funding requirement for schools and community colleges, commonly referred to as the minimum guarantee. Both state General Fund and local property tax revenue apply toward meeting the minimum guarantee. The Proposition 98 minimum guarantee is determined by one of three tests set forth in the State Constitution (known as Test 1, Test 2, and Test 3). These tests are based on several inputs, including changes in K-12 average daily attendance, local property tax revenues, per capita personal income, and per capita General Fund revenue.

Supplemental Appropriation Required in Test 3 Years. When the minimum guarantee is determined by Test 3, the state is typically required to make a supplemental payment in addition to the amounts determined by the Proposition 98 formulas. This is because of a statutory provision related to Proposition 98 that requires K-14 funding per student to grow at least as fast as per capita General Fund spending on non-Proposition 98 programs in Test 3 years.

Role of Property Taxes in Education Funding. Because the Proposition 98 minimum guarantee is met using state General Fund and local property tax revenues, changes in the amount of local property tax revenues can affect (1) state education costs and (2) total funding for schools and community colleges. These fiscal effects, however, vary based on which of the three tests is used to determine the minimum guarantee. In Test 1 years, the state provides a fixed share of General Fund revenues to schools (roughly 40 percent). Thus, in Test 1 years changes in education property tax revenues have no effect on state education costs but affect the total funding schools and community colleges receive. In Test 2 years, increases or decreases in local property taxes are offset by a commensurate change in the amount of state aid to educational agencies. Thus, in Test 2 years, changes in property tax revenues affect state costs, but do not affect the total amount of funding for schools and community colleges. Under Test 3, the relationship between property tax revenues and state aid is similar to Test 2 (increases or decreases in property taxes are offset by commensurate changes in the amount of state aid to schools), but the amount of property tax revenues can also have an effect on the calculation of the supplemental payment to school and community colleges. In general, this supplemental payment increases if property taxes increase and decreases if property taxes decrease.

Property Tax Revenues Contribute Toward Meeting District Per-Pupil Funding Amounts. Each school and community college district is eligible to receive a certain level of general purpose per-pupil funding, as specified in the annual budget act. Most school districts receive this funding from a combination of local property tax revenues and state General Fund revenues, while most community college districts receive this funding from local property taxes, student fees, and state General Fund revenues. If a school or community college district's local property tax revenue (and student fee revenue in the case of community colleges) is insufficient to fund the authorized per-pupil rates, the state provides General Fund revenues to meet the statutory requirements. Conversely, if a district's non-state resources alone exceed the per-pupil rates, the district does not receive general purpose state aid. (These districts historically received only the minimum amount of state aid

required by the State Constitution—known as “basic aid.”) This latter type of district is commonly referred to as a basic aid district. Only a small portion of school and community college districts statewide are basic aid.

Minimum Guarantee “Rebenched” to Ensure Property Tax Shifts Do Not Affect Schools and Community Colleges. Because the amount of school and community college property tax revenues can sometimes affect the Proposition 98 calculation, measures that shift the distribution of property taxes among local governments can unintentionally increase or decrease the state’s overall funding requirement for schools and community colleges. To ensure that these property tax shifts have no effect on the total amount of funding schools and colleges receive, the state “rebenches” the minimum guarantee any year in which it adopts policy changes that affect the amount of property taxes that schools or colleges receive. (Technically, the state’s General Fund Proposition 98 obligation is rebenched/adjusted to account for the shift in the amount of property tax revenues going to schools and colleges.)

RDA Pass-Through Payments

RDAs Made “Pass-Through Payments” to Affected Local Governments. Prior to their dissolution, many RDAs made pass-through payments to local governments to partly offset these agencies' property tax losses associated with redevelopment. The amount of these pass-through payments reflected, in part, state laws in effect at the time the RDA project area was created.

Pre-1994 Law Generally Allowed Amount of Payments to Be Negotiated. Before 1994, the terms of pass-through payments generally were negotiated between the RDA and a local agency. Most negotiations occurred between a city RDA and the county and special districts. School and community college districts (other than basic aid districts) typically were not as active in these negotiations—in part because, after 1972, the state backfilled them for any property tax losses.

Assembly Bill 1290 Replaced Negotiated Agreements With a Schedule of Payments. Chapter 942, Statutes of 1993 (AB 1290, Isenberg), eliminated RDA authority to negotiate pass-through payments and established a statutory formula for pass-through payment amounts for new project areas. Post-1993 pass-through payments generally are distributed to all local agencies and the amount each agency receives is based on its proportionate share of the 1 percent property tax rate in the project area. Assembly Bill 1290 requires the share of property tax increment passed through to local governments to increase at established points in the timeline of the redevelopment project. Thus, the share of property tax increment passed through to local governments grows over the life of a redevelopment project.

Pass-Through Payments Continue Until RDA Obligations Are Paid in Full. Under redevelopment dissolution, county-auditor controllers continue to make pass-through payments to local governments using some of the revenue that previously would have been allocated to RDAs. These payments to local governments currently total over $1 billion annually and likely will increase in the near future as property tax revenues grow. As each RDA’s debts are repaid, however, the RDA project ends and the related pass-through payments associated with that RDA cease. Within a few decades, therefore, all pass-through payments to local governments will end. Instead, local governments will receive additional property taxes—their share of the property tax revenues currently being used to pay RDA debts.

Most School and Community College Pass-Through Payments Do Not Count Toward the Minimum Guarantee. The majority of pass-through payments received by school and community college districts do not count toward the minimum guarantee. This is because the law in effect when most of the older redevelopment project areas were created and pass-through payments established (before 1993) did not include these funds in the calculation of the minimum guarantee. In addition, the law governing pass-through payments for redevelopment project areas established after 1993 requires only about half of pass-through payments to count in the calculation of the minimum guarantee. Pass-through payments, therefore, generally provide a net increase in total resources for school and community college districts, resources they typically use for infrastructure purposes.

PROPOSAL

[**Note:** After publication of this letter, the LAO determined that the highlighted text in the fourth paragraph below should not be included. This modification does not change the measure's fiscal effect.]

Reverses the Dissolution of Redevelopment. The measure restores RDA authority to engage in all of their previous functions. In addition, the measure permits a city or county that previously sponsored an RDA to reactivate the agency by a resolution of the entity's governing body adopted within 180 days of the passage of the measure. If a city or county does not reactivate its RDA, the process of dissolving the RDA and distributing its resources to affected local governments continues.

Restores RDA Revenue, Assets, and Obligations. Under the measure, a reactivated RDA receives the same amount of property tax increment revenue it would have received absent dissolution. (That is, the base year used to calculate its tax increment would reflect the original start date of the agency's project area.) A reactivated RDA also presumably assumes responsibility for (1) assets the agency held prior to dissolution that have not been distributed to affected local governments and (2) unpaid debts incurred by the agency prior to dissolution. (Statewide, these debts total over $2.5 billion.) In addition, reactivated RDAs would not be required to comply with asset transfers ordered by the SCO as part of the redevelopment dissolution process.

Changes Several Provisions Governing Reactivated RDAs. The measure makes several major changes to provisions of state law as they relate to reactivated RDAs. Specifically, the measure (1) extends the timeline of reactivated redevelopment project areas by 40 years, (2) removes limitations on time that property tax increment may be diverted to repay RDA debt, and (3) eliminates restrictions on the total amount of property tax increment that may be allocated to a specific project area. Under the measure, therefore, a reactivated project that otherwise would end in 2020 could be extended to 2060 and could collect tax increment for decades longer.

Alters Components of Prior Redevelopment Changes. The measure changes several provisions of state redevelopment law that apply to the reactivated RDAs, as well as to any agencies created in the future. Specifically, the measure: (1) broadens the definition of blight, (2) reduces the amount of RDA property tax increment that must be used for low- and moderate-income housing, (3) removes limitations on the amount of outstanding debt an RDA may have at any time, and (4) shortens from 2 years to 90 days the time provided for public review of new or amended redevelopment plans.

Modifies Calculation of Pass-Through Payments for Schools and Community Colleges. For all reactivated RDA and new projects areas, the measure modifies the calculation of post-1993 pass-through payments for school and community college districts. Under the measure, these payments to

school and community college districts no longer would grow over the life of a redevelopment project. Instead, these payments would be equal to a fixed proportion (30 percent) of a district's share of RDA property tax increment—that is, the share of property tax revenue the district would have received if the RDA did not exist and the funds were distributed as normal property taxes.

FISCAL EFFECT

Redirects Property Taxes From General Government Purposes to Redevelopment

By allowing cities and counties to reactivate their RDAs and create new redevelopment project areas, the measure redirects property taxes (including the assets of former RDAs distributed as property taxes) from other local governments to RDAs. The reactivated and new RDAs would make pass-through payments to affected local governments, partly offsetting their property tax losses. The RDAs would use the funds remaining after pass-through payments to pay debts and obligations incurred prior to RDA dissolution and undertake new redevelopment activities. The extent of property tax redirection would depend on (1) the number of RDAs that are reactivated and (2) the number of new and expanded redevelopment projects adopted in the future. Given the reluctance of many cities and counties to eliminate redevelopment, it seems reasonable to assume that they would reactivate the vast majority of RDAs. In addition, the measure relaxes some provisions of redevelopment law previously enacted to constrain redevelopment activity. Thus, the measure likely would result in a substantial increase in the use of redevelopment statewide.

Under these assumptions, the measure would redirect between $1.5 billion and $2 billion in net local revenue (property tax revenue losses net of pass-through payments) per year from other local governments to the RDAs in the short term—with over half (around $1 billion dollars) redirected from school and community college districts. Over time, the amount of net local revenue redirected from local governments to redevelopment likely would grow to several billion dollars per year—with over half (a few billion dollars) redirected from schools and community college districts.

School and Community College Funding

Short Term. In the short term, the measure's redirection of net local revenues to redevelopment probably would have no effect on the minimum guarantee because the state's practice has been to rebench the minimum guarantee in these types of situations. Reductions in net local revenues for nonbasic aid school and community college districts would be fully offset by an increase in state General Fund. Therefore, the measure likely would increase state education costs by around $1 billion per year, but would have little or no net effect on nonbasic aid districts. Local revenue reductions for basic aid districts, however, would not be offset by state General Fund. As a result, total basic aid district funding likely would be decreased by tens of millions of dollars per year.

Long Term. Over the long term, the redirection of net local revenue from schools and community colleges to RDAs would grow to a few billion dollars per year. The fiscal effect of these redirections on the (1) state and (2) schools and community colleges would vary annually depending on which test is used to determine the minimum guarantee. In Test 2 years, for example, school and community college net revenue reductions would be offset by increased state aid. This would result in increased state education costs of a few billion dollars per year but little or no net effect on school and community college funding. Conversely, in some Test 1 and Test 3 years, increased state aid might not fully offset the redirection of school and community college funds to RDAs. In these years, (1) the increase in state

education costs resulting from this measure could be somewhat less—ranging from $1 billion dollars to a few billion dollars per year—and (2) school and community college funding could be reduced—potentially by a few hundred million dollars to a few billion dollars per year. In all cases, increased state education costs would reduce the amount of resources available for other state funding obligations by a like amount.

Other Long Term Effects. In addition to these statewide fiscal effects, the measure would affect the funding available to individual school and community college districts. Specifically, the measure, by extending the number of years most RDAs would make pass-through payments, likely would increase statewide funding for nonbasic aid districts by a couple hundred million dollars per year. Furthermore, because the state does not backfill basic aid districts when their property taxes are reduced, statewide revenues to these districts would decrease by a couple hundred million dollars per year.

Potentially Decreases Costs and Increases Revenues For Cities and Counties

Many cities and some counties entered into financial agreements with their former RDAs in order to reduce the sponsoring government's costs or increase its revenues. This resulted in fiscal benefit for these cities and counties. By allowing these agreements to be reestablished, the measure would restore this fiscal benefit to some cities and counties. The amount of this fiscal effect is unknown.

Summary of Fiscal Effect

This measure would have the following major fiscal effects:

- Increased resources for local redevelopment activities, growing to several billion dollars more per year, resulting in decreased resources for state and other local government activities of the same amount.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance