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How We Pay For Growth

Op-Ed
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Author: William Fulton

California's Proposition 13 -- a citizen anti-tax initiative -- has turned out to be the most important planning law in the state. It has altered the nation's attitude about how to pay for growth, and, in the process, has been a major force in shaping the urban and suburban landscape we see throughout the country today.

Once upon a time, growth was good. Not just because there was a philosophy that more people improved a community -- or a state. But because there was a financial system based on the assumption that as communities grew, the value of their properties would grow commensurately. And so paying for the cost of new growth by taxing everybody -- or, at least, all the property owners -- was fair, because in the end everybody would benefit.

All that went out the window 25 years ago this week -- on Tuesday, June 6, 1978, when the voters of California passed Proposition 13, a citizen initiative that cut property taxes by more than half.

Prop. 13 is often credited with touching off a national tax revolt that has continued to this very day -- as evidenced by the Bush Administration's recent $350 billion tax cut. But as my fellow writers at ***California Planning & Development Report*** and I point out in a new report commemorating this anniversary, Prop. 13 did much more than increase pressure to cut taxes. It altered the nation's entire attitude about how to pay for growth -- and, in the process, it has been a major force in shaping the urban and suburban landscape we see throughout the country today.

Very simply, the Prop. 13 psychology changed our view of growth from good to bad. New development that once helped us prosper now threatened to bankrupt us. As a result, the concept that "growth must pay for itself" became deeply embedded in our national psyche. And that has changed everything about the planning and development game.

Fiscal zoning and competition between municipalities for tax revenue is nothing new. Neither is the vigorous political jockeying within any community over who pays for new growth, nor the slow-growth desire to "pull up the drawbridge", nor even the practice of requiring two-thirds voter approval for local school bonds. All these things existed before 1978. But all were accelerated by the passage of Proposition 13.

Part of Proposition 13's intent, of course, was to reduce the size of government by reducing the amount of tax revenue available. But it is not the basic impulse of government to cut its own size. Rather than do that, local government agencies throughout the state have gone into survival mode in two different ways. First, they have intensified their competition with one another for the revenue sources available. Second, they have been endlessly inventive in finding new sources of revenue that are not subject to Prop. 13's limitations.

And because local government revenues sources are so closely tied to land and real estate development, this new "post-Prop 13" culture was quickly translated into tangible changes on the urban landscape, many of which were tied to post-Proposition 13 revenue-raising strategies.

The "auto mall" is now common throughout the United States, but it was invented in California -- not by the auto industry trying to sell cars, but by local governments trying to capture sales taxes. The plethora of outlet malls, entertainment retail centers, and regional malls is also partly the result of Proposition 13. So is the boomlet in the creation of new cities in the last twenty years -- because for the first time in history, a California community could incorporate by transferring money out of the county treasury rather than raising taxes. Many of California's sprawling regional development patterns are the result of Proposition 13 also. Well-located cities have been able to cherry-pick retail centers, high-end housing, and other tax "winners". Meanwhile, starter homes and other tax "losers" have been relegated to distant locations on the metropolitan fringe, often in unincorporated areas, where county leaders are desperate to generate any types of revenue they can get.

Similarly, California has become home to some of the most peculiar revenue-raising mechanisms in the history of American public finance. Parcel taxes, previously not permitted, are now common. Mello-Roos taxes were invented specifically to circumvent Proposition 13, and in the process created a municipal bonding mechanism that many on Wall Street still don't understand. Development impact fees are now a basic part of the California landscape -- as is the "nexus consultant," whose job it is to prove the relationship between the fee being charged and the problem being created by the project. The state has also seen creative use of many different types of assessment districts. The end result has been to shift most of the cost of new infrastructure from property taxpayers to developers and new homebuyers.

What is perhaps most surprising is that this basic model of California planning -- the Post-Prop. 13 model, we'll call it --has survived all the upheavals of the last 25 years. Slow-growth sentiment has chilled whenever the real estate market has tanked, but it didn't vanish. Even when there was nary a construction loan to be found in the whole state, land developers kept going after specific plans and development agreements, and slow-growthers kept suing them and putting their projects on the ballot.

Similarly, just when the fiscal zoning fad should have been fading into the background, the harsh financial realities of the 1990s gave it new life. In 1992 and 1993, the state government reminded the locals of who's boss by shifting 25% of the property tax in the state -- that's somewhere around $4 billion -- away from cities and counties to the schools. Housing and other property tax-oriented development projects have been a bad deal ever since Proposition 13 passed. Now they're a much worse deal. And it's pretty clear that when the dust settles from the current state budget crisis, local governments will be more desperate than ever for new revenue -- and will use land-use authority more aggressively than ever to pursue it.

In short, even in the 21st Century, we seem to be operating with more or less the same planning and fiscal architecture that we've had for close to two decades -- an architecture that has led to unnecessary competition among cities, ghettoizing of land uses, and regional imbalances in our large metropolitan areas.

As usual, a whole variety of incremental land-use reforms are inching their way through the California Legislature this year. But even if they pass, none of them will have a fraction of the impact of Proposition 13 -- a citizen anti-tax initiative that has turned out to be the most important planning law in California, and the bellwether of the most important shift in the psychology of growth politics that we have since in the United States in the last 25 years.

William Fulton is president of ***Solimar Research Group*** *and editor and publisher of* ***California Planning & Development Report****. CP&DR's new special report on the 25th Anniversary of Proposition 13 is available for sale at* ***www.cp-dr.com****.*

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Prop 13

Submitted by Daniel P. O'Brien (not verified) on 12 June 2003 - 11:47am.

I think Prop 13 was less influental than CEQA in shaping California's developed landscape for the last 25 years. No doubt, Prop 13 dramatically changed the City's ablitity to pay for new growth, but CEQA with its uncomprimsing standards is the cause for sound walls enclosing subdivisions, high speed six-lane divided arterials, and greenfield pod-oriented land forms. I would be interested in reading studies about California growth under the hypothical scenario of Prop 13 without CEQA. I'd suspect that based on economics and elimination of the CEQA voice, we'd see more compacted growth than seen in the last 25 years.

Prop 13

Submitted by Don Godi,FASLA (not verified) on 10 June 2003 - 2:44pm.

If government would shrink as intended all the municpalities would not need the money they seem to want to get from you and me by way of new development. Can we ever get good planning/design when it is all tied to GOVERNMEMT greed?

Your article

Submitted by Anthony Hedayat (not verified) on 8 June 2003 - 10:44pm.

Dear Mr. Fulton,

I read your article with great interest as one who does not like urban sprawl. But I am finding it difficult to accept the premise that Prop.13 is the cause. Regardless of prop. 13, from my perspective, the cause of sprawl is due to both land costs (and taxes thereto) in conjunction with the fact that we have only one clearly dominant form of transit...the car. I do agree that governments are like the tentacles of a alien monster. Where you cut one off another will grow ad infinitum. To that all I can repeat are the words of past statesmen, that small government is good government. Your second point about why sprawl occurs, relative to lower income housing, due to cities wanting to cherry pick high end users also makes no sense to me. Unless you mandate the use of land to owners (that mine gets to be max value and yours must be subsidized which is socialist) how they get to use their property, the free market does what it does.

I look forward to your points of clarification so that I may better understand your position.

Thank you,

Anthony.

Prop 13

Submitted by marc (not verified) on 8 June 2003 - 9:35am.

I agree 100 %. Add in nimbyism, combined with gentrification and there exists little opportunity for affordable housing.

Not ONLY due to the California tax structure - CRAs are to Blame

Submitted by Tom Rubin (not verified) on 4 June 2003 - 10:45am.

Speaking as someone who has a little experience with auto malls in California, I think Mr. Fulton has a point. While I certainly do not believe that it is ONLY due to the California tax structure that auto malls exist, it is a very strong selling point. In fact, there is a very strong local tax reason for auto malls that he DIDN'T mention (I don't know if this was due to space limitations or not).

Here is one way it works in California. A local city sets up a Community Redevelopment District, or "CRA." These were originally designed to help develop depressed areas. When all the CRA powers are utilized, the CRA -- generally, a semi-autonomous city-created entity -- can offer very attractive deals to businesses, and few businesses have a better match between the powers of a CRA and what the tenant wants than auto dealers.

First, CRA's do have the right of eminent domain, so they can acquire land, in large chunks, in a way that no private landholder could do (in existing, developed, multi-use areas, of course, I'm not talking about a single landowner who controls 5,000 acres). Second, CRA's can issue tax-exempt debt to finance the acquistion of the land and even the construction. Since the savings are passed through to the tenants, this is another major savings.

Now, here is where things get real interesting. Third, the new tenants can get ad velorum tax tax abatements. Fourth, the remaining property taxes now go to the CRA for a period of several years, taking the COUNTY's share. (As you might guess, CRA's are not real popular with County governments in California.) The property taxes received by the CRA are used to do further "redevelopment," with the CRA's often not really accountable to anyone.

Gee, does this look to anyone like it might be an absolute classic way to build the monster agency that ate Cleveland? (Well, Cleveland is not in California, so make that "... ate Los Angeles.")

Now, in California, a good share of the sales taxes -- 8.25% in Los Angeles County right now -- goes back to the CITY where the sales were made, as general funds. This was Mr. Fulton's main point, and it is a strong one.

However, as you can see, the overall structure of CRA's power in parcel accumulation through eminent domain, tax-exempt borrowing for land acquistion and real estate improvements, ad velorum tax abatements for tenants, capture of the remaining ad velorum taxes for the CRA, and sales tax capture for the CRA's sponsoring city make a very powerful package.

Like just about any other business, auto sales can be very competative. When dealers are offered very attractive terms to relocate to a new city, almost all will listen very carefully. Some will accept the first offer, but others will shop around -- which means, in many cases, going to the present host city and asking, "we've got an offer to move to City Y; why don't you have a CRA like they do?" Gee, guess what, now every city is throwing money at auto dealers with both hands just to attempt to stay even.

Again, I am NOT claiming that auto malls are nothing but a tax dodge, there are other justifications for them. There are strong reasons for co-location, particularly as ownership of auto dealerships is getting more and more concentrated in many places, with a single parent often owning a half dozen or more, often more than a dozen, different dealerships in close proximity -- for example, my Lexus dealer is located right next to an Infinity dealer on one side and a Jag dealer on the other -- all owned by the same people.

But, even with the other valid reasons for the development of auto malls, I have to say that the very strong tax and "rent" reduction results that I've laid out above are a strong reason for this movement.

Tom Rubin

Agree 110%

Submitted by Christopher D. Brown AICP (not verified) on 2 June 2003 - 4:31pm.

I don't always agree with William Fulton, but in this case he hits the nail on the head. Of course the nail was bought at Home Depot, but what do you expect in this day and age.