CALIFORNIA BUDGET PROJECT

Updated January 27, 2011

What Does the Research Say About Redevelopment?

For nearly seven decades, California law has authorized cities and counties to establish redevelopment agencies (RDAs) in order to reduce blight. Once established, RDAs receive most of the growth in property tax revenues attributable to increases in property values ("tax increment") in the redevelopment project areas.[1] Absent redevelopment, schools and other local agencies would receive these revenues. Currently, RDAs receive approximately 12 percent of statewide property tax revenues, up from 4 percent in 1983-84.[2] As part of his 2011-12 Proposed Budget, Governor Jerry Brown proposed to dissolve RDAs by July 1, 2011.

Independent research on redevelopment in California – more broadly referred to as "tax-increment financing" (TIF) in other states – is limited. Studies find mixed results as to whether TIF boosts property values and results in increased property tax revenues. However, the most comprehensive independent study of California RDAs, conducted by the Public Policy Institute of California, found that redevelopment activities in most RDAs studied failed to generate enough growth in property values to account for the tax increment revenues they received. A small body of academic literature also examines the extent to which TIF projects boost economic activity, and some of this research finds evidence that TIF projects simply shift economic activity ***within*** municipalities rather than creating ***additional*** economic activity. For example, one study suggests that when employment increases in TIF project areas, it decreases in other parts of the city, which could mean that TIF projects draw jobs from elsewhere in the city, rather than generating net new jobs.

The California Budget Project reviewed independent research findings on the effectiveness of RDAs and of TIF more broadly. Key findings are briefly summarized below.

Michael Dardia, *Subsidizing Redevelopment in California* (Public Policy Institute of California: January 1998).[3]

This study showed that the vast majority of California redevelopment projects studied failed to generate enough growth in property values to account for the tax increment revenues they received. Specifically,

[1] A portion of the tax increment revenues must be shared with other local agencies, including counties and school districts, and at least 20 percent must be used to preserve, improve, or expand the supply of affordable housing. The state typically backfills school districts' loss of property tax revenues through the calculation of the Proposition 98 guarantee.

[2] This varies widely across the state. According to the Legislative Analyst's Office, "some agencies have placed so much property under redevelopment that as much as one-fifth of their countywide assessed property values is under redevelopment. The City of Fontana's redevelopment agency receives more than two-thirds of property taxes paid in the city." Legislative Analyst's Office, *Governor's Redevelopment Proposal* (January 18, 2011).

[3] http://www.ppic.org/content/pubs/report/R_298MDR.pdf

1107 9th Street, Suite 310
Sacramento, California 95814
P: (916) 444-0500
F: (916) 444-0172
cbp@cbp.org
www.cbp.org

this study tracked a sample of 38 California redevelopment projects over 13 years and found that they collectively generated just half of the tax increment revenues they received in 1994-95. The author concluded that the subsidy from other jurisdictions to those RDAs totaled $38 million that year and estimated that the total subsidy for a larger sample of 114 RDA projects could have been about $170 million annually. In addition, he concluded 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."

Richard F. Dye and David F. Merriman, "The Effects of Tax Increment Financing on Economic Development," *Journal of Urban Economics* 47:2 (March 2000) and Richard F. Dye and David F. Merriman, "The Effect of Tax Increment Financing on Land Use," in Dick Netzer, ed., *The Property Tax, Land Use, and Land-Use Regulation* (Cheltenham, United Kingdom, Edward Elgar Publishing: 2003).[4]

These studies found that municipalities that adopt TIF simply redirect economic development activity to TIF project areas at the expense of the rest of the city. Specifically, the researchers examined several hundred municipalities in Illinois and found "no positive impact of TIF adoption on the growth in citywide property values. Any growth in the TIF district is offset by declines elsewhere." The authors concluded that "policymakers should use TIF with caution. It is, after all, merely a way of financing economic development and does not change the opportunities for development."

Paul F. Byrne, "Does Tax Increment Financing Deliver on Its Promise of Jobs? The Impact of Tax Increment Financing on Municipal Employment Growth," *Economic Development Quarterly* 24:13 (2010).[5]

This study found that "contrary to the claims of municipal leaders touting TIF as a job creator, there is no evidence that TIF adoption in general has a positive impact on municipal employment." Based on an analysis of municipalities in Illinois that adopted TIF, this study suggests that any increase in employment within TIF project areas is simply the result of shifting jobs from elsewhere in the city.

John E. Anderson and Robert W. Wassmer, *Are Local Economic Development Incentives Effective in an Urban Area?* California State University, Public Policy and Administration Working Paper No. 99-03 (November 18, 1999) and John E. Anderson and Robert W. Wassmer, *Bidding for Business: The Efficacy of Local Economic Development Incentives in a Metropolitan Area* (Kalamazoo, Michigan, W. E. Upjohn Institute for Employment Research: 2000).[6]

These studies found that the share of residents of TIF areas who were employed declined after TIF projects began because population growth in these areas exceeded job growth. Based on an analysis of TIF projects in the Detroit metropolitan area, this study concluded that "it is hard to argue in favor of the benefits of new jobs for existing residents when we have found that an incentive can bring a greater number of new residents than new jobs, and thus decrease residential employment rates." However, the study also found that increased job opportunities in TIF areas tended to benefit low-income residents, which reduced the poverty rate in these areas.

---

[4] http://americandreamcoalition.org/landuse/TIFsinIllinois.pdf, http://ideas.repec.org/a/eee/juecon/v47y2000i2p306-328.html, and http://www.e-elgar.com/bookentry_main.lasso?id=3041

[5] http://edq.sagepub.com/content/24/1/13

[6] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=195148 and http://www.upjohninstitute.org/publications/titles/bb.html

Joyce Y. Man and Mark S. Rosentraub, "Tax Increment Financing: Municipal Adoption and Effects on Property Value Growth," *Public Finance Review* 26:523 (1998).[7]

This study found that median home values in Indiana cities that adopted TIF projects increased by 11.4 percent relative to what they would have been without TIF projects. However, unlike California and many other states, Indiana did not require a finding of blight in TIF project areas at the time of the study. This study's results could reflect that municipalities with fast-growing property tax bases choose to adopt TIF in order to capture tax increment revenue, not that TIF projects themselves are responsible for the growth.[8]

Paul F. Byne, "Determinants of Property Value Growth for Tax Increment Financing Districts," *Economic Development Quarterly* 20:4 (November 2006).[9]

This study finds that property values tend to increase more when TIF projects are located in less dense areas, places with higher vacancy rates and older buildings, and industrial areas close to municipal centers, among other things. In addition, the study's findings lend "some credence to the criticism that TIF success is partly attributable to the natural pattern of growth within municipalities," meaning that increased property values in TIF project areas reflect, at least in part, general economic trends that would have occurred even without redevelopment. This study bases its conclusions on an analysis of TIF districts in the Chicago metropolitan area.

Joyce Y. Man, "Effects of Tax Increment Financing on Economic Development," in Craig L. Johnson and Joyce Y. Man (eds.), *Tax Increment Financing and Economic Development: Uses, Structures, and Impact* (Albany, New York, State University of New York Press: 2001).[10]

This article reviews the research on TIF, including national surveys, case studies, and econometric analyses of TIF programs, and concludes that "empirical studies have yielded conflicting conclusions about the effectiveness of TIF programs."

Jeffrey I. Chapman, "Tax Increment Financing as a Tool of Redevelopment," in Helen F. Ladd, ed., *Local Government Tax and Land Use Policies in the United States* (Cheltenham, United Kingdom, Edward Elgar Publishing: 1998).[11]

This article concludes that "when studied *ex post* on a case-by-case basis, some [TIF] projects seem to stimulate significant redevelopment while others do not. However, the limited empirical work results in few conclusions that can be generalized." In addition to reviewing the research on TIF, the author outlines several policy issues related to TIF, including whether TIF projects are "self-financing" and whether municipalities use TIF "as a tool of redevelopment finance or a tool to relieve fiscal stress."

[7] http://pfr.sagepub.com/content/26/6/523.short

[8] Rachel Weber, Saurav Dev Bhatta, and David Merriman, "Does Tax Increment Financing Raise Urban Industrial Property Values?" *Urban Studies* 40:10 (September 2003), downloaded from http://usj.sagepub.com/content/40/10/2001 on January 20, 2011.

[9] http://edq.sagepub.com/content/20/4/317.abstract

[10] http://www.sunypress.edu/p-3374-tax-increment-financing-and-eco.aspx

[11] http://www.e-elgar.co.uk/bookentry_main.lasso?id=1332

Jeff Chapman, "Tax Increment Financing and Fiscal Stress: The California Genesis," in Craig L. Johnson and Joyce Y. Man (eds.), *Tax Increment Financing and Economic Development: Uses, Structures, and Impact* (Albany, New York, State University of New York Press: 2001).[12]

This article examines the history of redevelopment in California and suggests that "fiscal stress might influence the degree of TIF redevelopment that occurs" in the state. The author concludes that "TIF can be a useful tool. …But it only works correctly if it is carefully planned, monitored, and implemented under the light of public scrutiny."

The Bottom Line

The findings of this body of research are echoed in the Legislative Analyst's Office's (LAO) recent review of the economic literature. The LAO concludes that "there is no reliable evidence that redevelopment projects attract businesses to the state or increase overall economic development in California. The presence of a redevelopment area might shift development from one location to another, but does not significantly increase economic activity statewide."[13]

How Do Redevelopment Agencies Spend Funds Set Aside for Affordable Housing?

RDAs must deposit at least 20 percent of annual property tax increment revenues into a special fund called the Low and Moderate Income Housing Fund (LMIHF) to be used to preserve, improve, or expand the supply of affordable housing.[14] State law lists nearly a dozen activities that LMIHF dollars can be spent on, including property acquisition, construction, and rehabilitation.[15] Each year, RDAs report their total LMIHF expenditures broken out by eligible activity to the California Department of Housing and Community Development (HCD).[16]

The most recent HCD data available show that the largest share of LMIHF dollars spent by RDAs collectively in 2007-08 (31 percent) was used to pay debt service, including debt service for tax allocation bonds and notes, revenue bonds and certificates, and city or county advances and loans.[17] Approximately two out of 10 LMIHF dollars spent that year (21 percent) were used to acquire property, which includes real estate purchases, acquisition expenses, and the operation of acquired property, as well as relocation costs and payments.[18] Another 11 percent of RDAs' total LMIHF expenditures were used for housing construction in 2007-08, and 8 percent were used for housing rehabilitation and on- or off-site improvements. In addition, 13 percent of expenditures were used for planning and administration, and 13 percent were used to provide rental subsidies, assist first-time homebuyers with down payments, and purchase

[12] http://www.sunypress.edu/p-3374-tax-increment-financing-and-eco.aspx

[13] Legislative Analyst's Office, *Governor's Redevelopment Proposal* (January 18, 2011).

[14] RDAs may claim an exemption from this requirement if the community's general plan demonstrates that there is no need for affordable housing in the community or that less than 20 percent of the tax increment is sufficient to meet affordable housing needs. The California Department of Housing and Community Development's (HCD) annual redevelopment housing activities reports show that only a small number of redevelopment projects claim exemptions. See HCD's redevelopment housing activities reports, downloaded from http://hcd.ca.gov/rda/ on January 21, 2011.

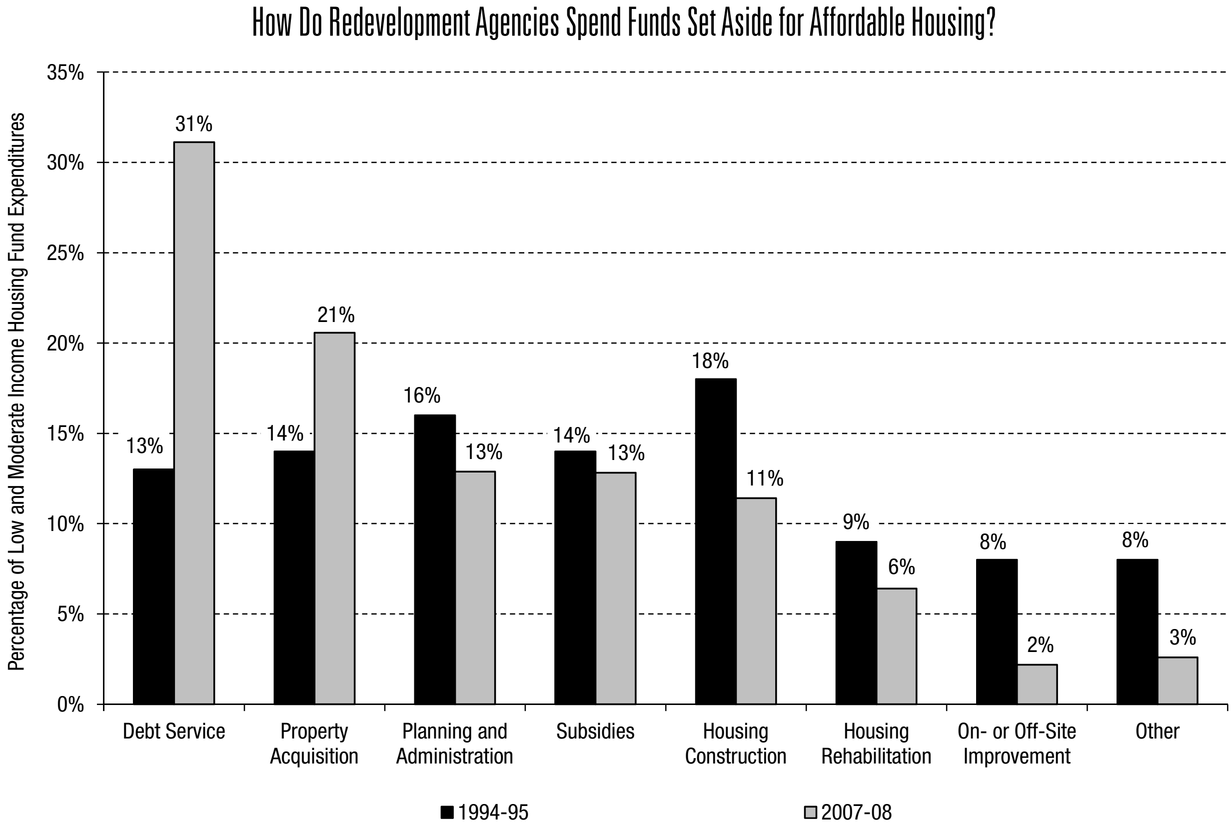
[15] See California Health and Safety Code Section 33334.2 (e).

[16] See http://hcd.ca.gov/rda/ for annual reports from 2000-01 to 2007-08.

[17] In addition, debt service includes US state and other long-term debt, interest expense, debt issuance costs, other debt service costs, and other expenditures. See http://housing.hcd.ca.gov/hpd/rda/07_08/ex_c-5_07-08.pdf.

[18] In addition, property acquisition includes site clearance costs and disposal costs. See http://housing.hcd.ca.gov/hpd/rda/07_08/ex_c-3_07-08.pdf.

affordability covenants.[19] Since 1994-95, the share of LMIHF dollars spent on construction, rehabilitation, and on- or off-site improvements has declined, while the share used to pay debt service and acquire property has increased.[20]



Source: California Department of Housing and Community Development and Senate Committee on Housing and Land Use

Useful Sources of Information on How RDAs Spend Funds Set Aside for Affordable Housing

California Department of Housing and Community Development, Housing Activities of California Redevelopment Agencies Annual Reports.[21]

These reports compile information reported by RDAs on their use of funds set aside in the LMIHF.

California State Controller's Office, Redevelopment Agencies' Annual Reports.[22]

These reports compile information on the financial transactions of RDAs.

---

[19] Planning and administration includes administration costs, indirect nonprofit costs, planning, survey/design, and professional services. See http://housing.hcd.ca.gov/hpd/rda/07_08/ex_c-7_07-08.pdf.

[20] In 1994-95, 18 percent of LMIHF expenditures were used for construction, 17 percent were used for rehabilitation and on- or off-site improvements, 13 percent were used to pay debt service, and 14 percent were used to acquire property. See *Ends or Means? Redevelopment Agencies' Housing Programs: The Summary Report From the Interim Hearing of the Senate Committee on Housing and Land Use* (California Senate Office of Oversight and Outcomes: November 13, 1996).

[21] http://hcd.ca.gov/rda/

[22] http://www.sco.ca.gov/ard_locrep_redevelop.html

***Ends or Means? Redevelopment Agencies' Housing Programs: The Summary Report From the Interim Hearing of the Senate Committee on Housing and Land Use* (Senate Committee on Housing and Land Use: November 13, 1996).**

This report summarizes information presented at a Senate Committee on Housing and Land Use hearing that examined how RDAs spend their money and to what extent they have increased the supply of affordable housing. Some of the issues raised during the hearing include the fact that some RDAs consistently report spending the majority of their LMIHF dollars on planning and administration, which may constitute waste, and that no state department is charged with ensuring RDAs are in compliance with redevelopment law.

Nancy Vogel, et al., *Where Does the Affordable Housing Money Go? Administrative Spending by Redevelopment Agencies Lacks Accountability* (California Senate Office of Oversight and Outcomes: September 30, 2010).[23]

This study concludes that "current laws and oversight give the Legislature and public no assurance that redevelopment agencies are using at least 20 percent of revenues to efficiently create affordable housing." Based on a small sample of California RDAs, some chosen randomly and others chosen because they consistently spent a large share of LMIHF dollars on planning and administration, this study finds some evidence that certain RDAs have misused funds set aside for affordable housing.

Mao Yang, *The Low-Mod Fund: RDAs Spending 100% of Total Expenditures on Planning and Administration*, Thesis, Master of Public Policy and Administration, California State University, Sacramento (Spring 2007).[24]

This study finds that each year between 2000-01 and 2004-05, less than one out of 10 RDAs spent ***all*** of their LMIHF dollars on planning and administration. In addition, the study identifies five RDAs – Atascadero, Kingsburg, Modesto, San Bruno, and Tulare County – that spent all of the LMIHF dollars on planning and administration during those five years in a row.

[23] http://www3.senate.ca.gov/deployedfiles/vcm2007/senoversight/docs/affordable%20housing%20report.pdf

[24] http://eureka.lib.csus.edu.proxy.lib.csus.edu/search/t?SEARCH=low%20mod%20fund&searchscope=